The Guaranty of Bank Deposits

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FOREWORD

The guaranty of bank deposits is a subdivision of the guaranty of bank credit. Bank credit is the purchasing power which a bank manufactures, and which manifests itself in two forms, namely, bank notes and bank deposits. In the first chapter of this thesis an attempt is made to outline very briefly the functions of a bank and its relations to its customers. The object of the chapter is to present the general nature of bank credit. The second chapter deals with the earliest attempts at guaranteeing notes and deposits. The first law guaranteeing deposits was the safety fund system of New York, passed by the legislature of that state in 1829. It was the intention of the legislators to guarantee only the notes, but through improper wording it was later interpreted to the effect that all debts were protected by the fund. Chapter three deals with the growth of bank deposits and conditions antecedent to the rise of the guaranty movement in the West. The growth of state banking from 1836 to 1907 is considered.

In chapters four to eight inclusive a summary of the bank guaranty laws of the various states is given. The experiences of operation of the guaranty laws are also presented. Attention is especially called to the fact that as each state is considered

no attempt is made to weigh, in the light of the experience of that state, the much-mooted questions of bank guaranty. The decisions of these questions are deferred to the ninth chapter where conclusions are drawn from the experiences of operation of the guaranty law.

In the preparation of this thesis I am deeply obligated to many persons. I am indebted to Dean Frank T. Stockton of the School of Business, University of Kansas, for many helpful suggestions in aiding me in choosing the subject. The late Professor A. J. Boynton gave me many valuable suggestions as to the procedure in outlining the work and collecting the material for the thesis. To Professor J.P. Jenson I am especially indebted for his patience in reading the manuscript, and for many constructive criticisms. The banking departments of various states, especially Oklahoma and Nebraska, furnished valuable data concerning the operation and experiences of the guaranty laws. The Federal Reserve Bank of Kansas City was especially helpful in furnishing recent data.

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Chapter I

The Bank And Its Customers

Introduction. The meaning of the term "bank" has undergone a very great change since the beginning of American history. In early Colonial days it meant an association of individuals having been granted the right to issue paper money, or bank notes as this money was called. This privilege of issuing bank notes distinguished a bank from any other association. Under our modern banking system state banks are practically prohibited from issuing bank notes by a ten per cent circulation tax. National banks and Federal Reserve banks are now the only banking institutions that have the right of note issue. Many bankers believe that by 1930 national banks will have been deprived of the note issue privilege.[1] At that time bonds put up as security for note circulation will have expired.

It is the purpose of this chapter to give a general survey of the purposes of a bank, its relation to its customers, and the relation of customers to their bank. This will serve as a foundation for the following chapters which are to be devoted to the discussion of the guaranty of bank deposits.

1. Bank Functions.[2] One of the important functions of a bank, as previously noted, is that of issuing bank notes. Horace White in his Money and Banking, page 198, says, "Bank notes are the banker's

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[1] In conversation Mr. E. A. Hanes, cashier of the First National Bank, Ottawa, Kans., told the writer that it is the consensus of opinion among bankers that after 1930 the note issue privilege will be vested only in Federal Reserve banks.

[2] White, Horace, Money and Banking.

promises to pay money to the bearer on demand. They are virtually orders of the president and cashier on the paying teller. They are of the same nature, and they operate in the same manner as checks drawn by depositors." Titles to bank notes pass in full by delivery, no indorsement being required, and each successive holder acquires the same rights against the bank.

Under well balanced banking and business conditions bank notes render valuable service to the issuing bank as well as to the note-holder. Before a note can circulate freely from hand to hand the holders must have complete confidence that it will be paid when presented at the issuing bank. To create this confidence the bank must have a sufficient reserve on hand with which to pay all notes that are presented. This confidence also presupposes a state of honesty, good judgment, and fair dealing on the part of the banker toward the public. The more reserve back of the notes issued and the more confidence the customers have in the bank's good management the less likely the notes will be presented for payment. Under our old national banking system three limitations were put on the issue of circulating notes: (1) The amount issued must not exceed the capital stock of the bank. (2) The issuing bank must purchase United States bonds to an amount equal to the note issue and deposit same with the treasurer of the United States for redemption of the notes. (3) Each bank must maintain in the United States Treasury a redemption fund in "lawful money" equal to five per cent of its note issue. If banks

were required to put up as security for note issue an amount equal to their circulating notes, there could be no profit from this source to the banks. The profit must come from what is known as the "uncovered issue", that is, the excess of circulation over the specie redemption reserve.

The utility of bank notes to the holder varies according to the density of population and banking facilities. In the regions of the North and East of the United States, where the population is heavy and banks are numerous, over ninety per cent of the volume of business is done by check, little paper money being required, while in the more sparsely settled regions of the West and South a greater proportion of the volume of business is done through the medium of bank notes. The notes having more acceptability than personal checks, because of the nature of the business transaction, are very desirable and convenient as a medium of exchange.

We shall next consider the function of deposit. In the United States and in many other countries, deposits have a much greater volume and effect than notes. Deposits under our modern banking system often range from ten to twenty times the amount of capital stock of the bank. According to a statement of one of the national banks of New York City, September 30, 1901, the individual deposits amounted to $29,923,255.97, while the capital paid in was only $2,000,000.[1] Deposits as the word signifies originally meant the leaving of cash with a bank. However, under present banking methods,

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[1] White, Horace, Money and Banking, p. 206.

cash deposits constitute only a small part of bank deposits, as loans and discounts form the bulk of them.. An illustration of deposit by loan and discount will serve to make this clear. A wants to borrow $1,000. He gives his banker his note at ninety days for $1,020.41. The bank credits A's checking account for $1,000, charging him the $20.41 as a discount or interest paid in advance. Or, suppose that A held notes receivable to the amount of $1,200; he could take these to his banker and sell them at a discount and receive credit on his checking account. Another way in which A may receive credit on his checking account, or may make a deposit, is to indorse and deliver to the banker checks drawn by others in A's favor, or indorsed by others to A. Thus there are at least three common methods of making deposits; leaving cash cash with the bank, leaving demand checks for collection and credit, and by borrowing from the bank and leaving the money on a checking account.

2. The Cash Non-Borrowing Depositor. From the different methods of making deposits as noted above we may divide, for the purpose of discussion, the depositors into two classes; the cash non-borrowing depositor, and the borrowing depositor. The former takes his money to the bank and usually in small amounts, for the purpose of safe keeping, or he may want to pay bills by check so as to avoid the inconvenience of having to carry a large amount of money on his person. This is annoying because of the dangers of robbery and loss. The bank makes no charge for cashing these personal checks of the

cash non-borrowing depositor, unless it be a nominal fee to cover bookkeeping expense. The question arises, where does the bank get its profit on such deposits? Let us explain by way of an illustration. B. L. Jones deposits on January 1, $200. He intends to use this as expense money for the next sixty days. Jones withdraws about $25 per week with which to pay his expenses, leaving the balance in the bank. The bank will lend probably seventy-five per cent of this balance to those wanting to borrow. It will keep only an amount on reserve to meet the current demand for cash.

3. The Borrowing Depositor. It is this class of depositors that make up the greater part of the deposits. The cash depositors are insignificant when compared to the depositors to which loans are granted. As previously stated the borrowing depositor gives his note to the bank and receives credit on his checking account for an amount less the interest on his note for the time it is to run. The depositor is not likely to withdraw all of this immediately, so the banker has another opportunity for profit, that is, on the undrawn balance of the depositor. For instance, C borrows $1,000 for sixty days. He pays interest on the full amount for the entire period that it is to run. During the period he checks out only $800. Here the bank has been asked to pay out $800, but has received interest on $1,000. It is from this class of deposits that the bank makes most of its profits, since this is the most common form of deposits.

4. Effect of Deposit Banking on the Circulation of Money; on that of Bank Notes.[1] The extensive use of deposit banking tends to

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1 Taussig, F. W., Principles of Economics, Vol. I, pp. 338-41.

have two opposite effects on the amount of money in circulation. In the first place, all deposit liabilities are demand obligations, and hence require a larger cash reserve held in readiness by banks to meet the demand for payment of checks. On the other hand checks are used extensively as a medium of exchange, thus reducing the requirements of bank note circulation.

Checks drawn against deposits are much more likely to be presented at the bank for payment than the outstanding bank notes. Bank notes pass from hand to hand by delivery only, the transferrer being under no further obligations if the note has passed in the regular course of business. Checks usually require indorsement and delivery. The indorsement carries with it certain implied warranties that the check is good and will be paid when properly presented. This extra obligation makes the check less acceptable, especially for small amounts. The amount for which the check is drawn is usually inconvenient to settle any other obligation except the one for which it was drawn. Because of this the check is usually deposited in some bank and sent through the clearing house for collection.

Under modern business practices retailers settle most of their buying obligations by check, while their sales result in the collection of a considerable amount of "cash" or "money" coming in in small quantities. This cash is deposited by the retailer with his banker, and is checked out again, probably by his customers, when they want ready cash with which to settle other small obligations.

Thus the checking system tends to cause the bank notes to be returned to the bank more often than they were before deposit banking came into existence.

5. The Nature of Bank Credit. The man who manages his business in a successful manner, will find, that in the long run his expenses, including investments and profits, will equal his income. This does not mean, however, that they are always the same, for there are periods when the expenses greatly exceed the income. The wheat grower must sell his wheat before paying for the harvesting expenses which are usually very heavy. The merchant may have to buy a large stock of merchandise and sell a part of it before paying his bill. Likewise the manufacturer of the same merchandise may have to postpone the payment for the raw materials until he has collected from the merchant. This gives rise to what is known as personal credit,[1] that is, the right to demand money from others at some future time. The extent to which a man may utilize his personal credit depends on his personal ability, integrity, and realizable wealth.

Bank credit differs from personal credit in that it may be made into a more generally acceptable form. An individual may exchange his personal credit for bank credit in which he may be able to secure cash from the bank to pay his indebtedness. In Money and Banking by Horace White, we find a splendid illustration of how a bank manufactures credit. "A man has $10,000 of his own money. He starts a bank. His neighbors deposit $50,000 with him. This money becomes

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1 Ely, Richard T., Outline of Economics, p. 285.

the absolute property of the banker. The depositors have simply a right to withdraw an equal amount whenever they like, which right can be inforced by law. The banker owns the money and the depositor has a claim, or right of action, against him for an equal sum. But the depositor will not draw the money out immediately; if he had intended to do so, he would not have deposited it at all. The banker finds by experience that some of his customers will bring in as much money as others draw out, so that $60,000 is on hand all the time. He infers that if his own $10,000, in connection with his good reputation, is considered by the public a good guarantee for $50,000, then the whole $60,000 will serve as a guarantee for a much larger sum."

It will be noted that in the above example only cash deposits are taken into consideration. Another form of deposit may be used in the process of exchanging bank credit for personal credit. I refer to the discounting of commercial paper, as when a man gives his note to the bank and receives credit on his checking account for an equal amount less discount. This note receivable held by the bank serves as an asset on which more credit may be extended. The deposit also is entered on the books of the bank as a liability.

6. The Necessity of Deposits. Property varies as to its acceptability. Gold and silver in reasonable amounts, and other forms of money are readily accepted for services, but very few salaried men would be willing to accept a harvesting machine, for instance,

at full value for services rendered. For example, what would a lawyer do with a warehouse full of harvesting machines if he could not exchange them for something of wider acceptability? The grocer would not accept them in exchange for groceries, the merchant would not accept them for clothing, neither would the landlord be willing to settle the rent bill in that way. Even money, when in the form of coin in large quantities, has its disadvantages as to acceptability. Few would accept twenty thousand dollars in cash as the selling price of a farm, but would rather have a check drawn against deposits made by the purchaser of the farm. The check is much safer against destruction by fire and theft, besides being much more easily carried around. This brings us to the conclusion, then, that in transactions of considerable volume and where the purchaser has little chance of defrauding the seller, the check has the wider acceptability.

The bank thus makes a business of studying individual credit and one of its great services to the public is its ability and willingness for a given renumeration to substutute what White calls a well-known credit for the individual less-known credit. President Hadley calls this operation the insurance of credit: "The bank may be said to insure credit. If it discounts a three months' note and allows the maker to draw checks upon the sum with which it credits him, it protects the public, which accepts such checks, from the risk of subsequent insolvency on the part of the maker. It is because this insurance is effective that the public will accept checks where it

will not accept promissory notes."[1]

The check is more desirable in making settlement between distant places. The great mail order houses perhaps owe their success to deposit banking and the checking system. Bank credit touches intimately the life of every individual. As civilization becomes more differentiated, the production and distribution of goods on which it rests become more intricate.

7. Conclusion. The development of bank credit has proved a great boon to mankind, but it is a blessing that connot be abused with impunity. As already indicated, commercial banks build their credit on a community's deposits. In a sense they become the trustees of this capital, and when this trust is abused either through dishonesty or incompetency, the public is the large sufferer. Dishonest bankers may build up large deposit accounts, make a wrong use of them and rob the community. Incompetent bankers may be the victims of dishonest and reckless borrowers with the same result. Bank credit, extended to assist in a productive process, is sound and wholesome only when that process ripens into goods which will liquidate the loan. Crop failures, fires, interrupted transportation, and other unforeseen calamities may intervene and upset the best calculations. The banker, after all, is only a human being, and speculation in its various degrees is his most insiduous temptation. This is a situation fraught with great public danger, and nowhere has this danger been greater than in the United States

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[1] Economics, p. 245.

with an adherence to the democratic principle of free banking. Bank notes and bank deposits are the two forms in which bank credit manifests itself, and since the bank as a corporation holds its commission from the government to engage in this business peculiarly affected with the public interest, the government attempts to guard the public from the dangers of these two instruments. With this view of the nature, the importance, and the dangers of bank credit we pass on to the consideration of the safeguards that have been thrown around bank notes and bank deposits.

Chapter II

Earliest Attempts at Guaranteeing Notes and Deposits-- The Safety Fund System of New York--1829

The Safety Fund System as it is called was an act passed by the New York legislature, April 2, 1829. The purpose of the law was the mutual insurance of bank notes, but because of a defect in the phraseology of the law, it was later interpreted to mean the insurance of "all debts" of failed banks.

1. Conditions Demanded Reform in Banking Administration in New York. In order to better understand the aim of the legislators in the passage of the new law let us look briefly at some of the conditions during the twenty year period immediately preceding the passage of the act. There was a tremendously rapid growth in the number of banks in the country during these two decades due to the increase in population, the rapid growth of business, and the expansion of commerce and industry. John Knox in his History of Banking in the United States, page 309, gives the following table relative to the number of banks, capital, circulation, deposits, and specie:

Table Showing the Number of State Banks in the United States in Various Years from 1811 to 1829

Year	Number of Banks	Capital	Circulation	Deposits	Specie
1811	88	$42,610,600	$22,700,000	----------	$ 9,600,000
1815	208	82,259,590	45,500,000	----------	17,000,000
1816	246	89,822,422	68,000,000	----------	19,000,000
1820	307	102,000,000	40,641,000	----------	16,672,000
1829	329	110,192,268	48,274,914	40,781,119	14,939,643

The number of chartered banks in 1811 was 88, while in 1829, eighteen years later, the number had reached to 329 banks, an increase of 274 per cent. In 1829 the capital was almost three times that of 1811, and the note circulation had more than doubled during the eighteen years. At the beginning of the period deposits were unknown in the banking business, but by 1829 they amounted to more than 40 million dollars. The amount of specie in circulation and on reserve in banks had about doubled.

New York, being the center of commerce and industry, and having a comparatively dense population, needed more banking facilities than any other state. Therefore, about one fourth of the banks of the country were located within her boundaries. None of the states had at that time, 1829, any adequate banking laws. Charters were granted to financial institutions by special act of the legislature, and usually for a period of from ten to twenty years. In 1829 over thirty bank charters in New York were to expire between 1831 and 1833. In order to prepare the way for any needed reform, the legislature had purposely fixed the expiration of the charters of a large number of banks at about the same time.

Horace White quotes from a letter written by Joshua Forman to Martin Van Buren in January, 1829, in which Mr. Forman pointed out some of the defects of the old banking regime. He showed in his letter that there was a lack of adequate laws providing for state supervision and punishment of offenders against best banking Morals.[1]

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[1] White, Horace, Money and Banking, p. 339.

Swindlers often bought out honest bankers, plundered the good assets and sold out to insolvent bankers.

The law did not provide for a check upon the issue of circulation, consequently, there were many disturbing financial periods.

Mr. Forman's suggestions[1] for regulation may be summarized as follows:

1. Provisions to insure payment of capital
2. To limit loans and discounts
3. To prevent the issuance of bills other than those payable on demand
4. To prevent speculation by bank officers in the depreciation of their paper
5. To prevent the transfer of assets to preferred creditors in case of insolvency
6. Proposed a board of commissioners
   a. To inspect, examine, and inforce legal restrictions
   b. Answerable to governor and removable by him
7. Proposed a fund to be raised from an annual payment of all of the banks
   a. According to capital
   b. To apply toward payment of debts of failed banks
   c. To accumulate until it shall amount to $500,000 or $1,000,000
8. Nor other banks were to be incorporated except those coming in under the system

2. Provisions of the Law.[2] The law known as the Safety Fund

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1 Knox, J. J., History of Banking in the United States.

2 Ibid.

System was passed without much difficulty and went into effect on April 2, 1829. It provided that every bank whose charter should be granted or extended thereafter, should pay into the "Bank Fund" one half of one per cent of its paid up capital each year, until the accumulated payments should equal to three per cent of the capital stock of the contributing banks. The disbursements from the fund were to be applied only for the payment of "the debts" of failed banks belonging to the system. Those that had not come into the system, because they were still operating under their old charters, granted prior to the passage of the law, were not assessed and were not to receive benefits from the fund in case of insolvency. The fund was not to be used, however, until the assets of the failed banks had been exhausted and the deficiency determined by judicial proceedings. Whenever the fund should be reduced the comptroller should call on the banks for additional contributions, at the same rate, as to time and amount, as the original ones. There was also a provision for the appointment of three commissioners to examine all the banks at least three times each year, or more if required to do so by the request of other banks. Any three banks might call for a special examination of any bank belonging to the system.

The three bank commissioners who were to have general supervision of the law were to be appointed; one by the governor with the approval of the senate; one by the banks of the southern portion of the state; the remaining banks were to appoint the third. In 1837 an amendment

provided that all three commissioners be appointed by the governor and approved by the senate. The commissioners were to examine each bank every four months, to give special examination upon request of three corporations, not to be personally interested in any bank, and to approve or reject the application of a new bank desiring to come into the system. No new bank should begin business until proof by oath that its capital had been paid.

3. Amendments. During the early years of the new law, as had been the case previous to its passage, many banks were failing to redeem their outstanding notes. To meet this situation the law was amended in 1837 so that two thirds of the fund might be used at once to redeem notes, the balance being reserved for other creditors. In 1840-42, however, so many failures occurred that the fund proved inadequate to meet both notes and deposits, and in 1843 the law was again amended to make notes a first lien upon the entire fund. The amendment came too late however, in 1838 the band deposit system was established and new banks after that date incorporated under the new plan, leaving a constantly decreasing number of banks to keep up the safety fund.

4. Operation of the New System. The panic of 1837 caused such hardships in the banking business that the new law went to pieces under the strain. Three safety fund banks, all in Buffalo, were reported to be in difficulties. It was at this time that the amendment, already referred to, applying two thirds of the bank fund to the re-

demption of notes, was passed. The amendment was made for the benefit of those three banks. The assets of the failed banks were sufficient to reimburse the bank fund so that there was no loss, in this case, from the redemption of the notes. Two other banks failed soon afterwards and their notes were paid and the fund replenished without loss. No other failures occurred until 1840.

Horace White in his splendid report of the experiences of the State of New York with the Safety Fund System says,

"During 1840 and the two following years eleven banks failed. The fund now had about $900,000, of which about $600,000 was applicable under the law of 1837 to the immediate redemption of circulating notes, the remainder being reserved for depositors. Those of the first three banks in the order of failure exhausted this sum. The bank commissioners in their annual report of 1841, said that the bank fund was primarily designed for the protection of noteholders, not depositors or general creditors. The fact that the law put all creditors on the same level was not understood by the public, or by the bankers themselves, and its expediency was called in question. In 1842 the law was amended so that after the payment of all liabilities charged against the fund at that time, the noteholders should have the first lien on it. In the constitution of 1846 noteholders were made preferred creditors of all failed banks."[1]

There are at least two reasons why noteholders should be made

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[1] White, Horace, Money and Banking.

preferred creditors. In the first place, it is not usually convenient for an individual to reject a bank note when offered to him. Quite often he is just about compelled to accept it whether he wishes to or not. This is especially true of wage-workers and the poor classes of people. These classes are usually least qualified to determine the solvency or financial condition of the issuing bank. Perhaps in many instances they would lose their jobs if they were not willing to accept bank notes as pay. Another reason for giving bank noteholders preference over depositors was the fact that deposit banking was of very recent origin and as yet not very well understood. It was so little used in 1829 that no mention was made of it in the original act. After recovering from the effects of the panic of 1837 deposits increased very rapidly. From 1836 to 1860 deposits increased over seven hundred per cent, while in the same period bank note circulation increased only fifty per cent.[1]

Writers on the subject disagree as to the likeness of bank notes and deposits. Macleod says, "Deposits are nothing but bank notes in disguise."[2] Dunbar seems to think they are the same, as is indicated in the following quotation:

"A little consideration of the manner in which notes are issued by banks will show that in the bank note we have only another form of liability, differing in appearance, but not in substance, from the liability for deposits. The bank note is the duly certified promise of the bank to pay on demand, adapted for circulation as a

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1 National Monetary Commission, p. 385.
2 Macleod, H. D., Theory of Credits, p. 600.

convenient substitute for the money which it promises. It is issued by the bank, and can be issued only to such persons as are willing to receive the engagement of the bank in this form instead of receiving money, or instead of being credited with a deposit. Thus the so called borrower, who in the first instance has been credited with a deposit and to whom the bank is, therefore, to this extent liable, may prefer to draw the amount in notes of the bank and to use them in making his payments. But in this case it is plain that the liability of the bank is charged only in form; it is still a liability to pay a certain sum of money on demand.....The notes issued by a bank are thus a liability distinguishable in form from its liability for deposits, and the function of deposit and issue, spoken of at the opening of this chapter, instead of being distinct, as is often assumed, are one in substance."[1]

The charges against the bank fund before the noteholders' prior lien amendment of 1842 went into effect, were so heavy that they absorbed everything it was likely to receive from the annual contribution of one half of one per cent. To meet the situation the state in 1845 issued its own stock to the amount of $900,000, in order to make immediate payment to the creditors of insolvent banks.[2] This was all paid back from the fund, principal and interest. In addition the fund redeemed a large amount of notes which had been fraudulently

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1 Dunbar, C. F., The Theory and History of Banking, pp. 17-18.
2 White, Horace, Money and Banking.

over-issued. This fraudulent issue could have been prevented had there been a provision in the original act relative to public supervision of note issue, as was passed the following year after the loss had occurred. According to White, "the whole amount of payment into the Safety Fund was $3,104,999, and of payments out of it to noteholders and depositors $2,600,000, the remainder having been paid as interest on the state's advances."

The first contributions were made to the fund in 1831. From the bank commissioner's report the following year we learn that 52 banks were operating under the system and 12 others not subject to it. The increase in circulation from January 1, 1829 to January 1, 1832 was from $4,508,056 in 1829 to $8,622,277 in 1832. There was also a corresponding increase in capital stock. Part of the increase was due to the canal fund held by the banks. New banks were organized in great numbers.

In 1835 there were 76 banks under the system with a capital of $26,231,460, while the capital of other banks was $5,175,000. The circulation of safety fund banks was $14,464,023, with specie held against this of $5,561,745. The additional specie fund held in city banks was $4,494,877. All banks were going strong at this report and the safety fund was in good condition, there being $400,000 to its credit.[1]

The panic of 1837 caused numerous bank failures and the Safety Fund was depleted, the act being suspended temporarily.

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[1] Knox, J. J., History of Banking in the United States.

From the bank commissioner's report of 1845 we note that the amount required for the payment of debts of insolvent banks was $1,017,000. The amount in the fund at this time was $179,193, leaving a deficit of $837,806. The amount that had already been paid from the fund was $1,502,170, plus the amount due insolvent banks, $1,017,000 makes a total charge on the fund by the failure of ten banks, $2,519,170.[1]

In 1846, Comptroller Flagg's report showed that the total contributions to the fund up to September 30, 1845, was $1,885,526.99, and the total amount of notes redeemed to this date was $1,769,922. This shows that the fund was sufficient for the redemption of notes of failed banks, but not sufficient to guarantee all the debts of insolvent institutions.

5. Why the Safety Fund System Was Not a Complete Success. The most talked about and perhaps the most outstanding objections to the Safety Fund law was expressed in the report of Millard Fillmore, Comptroller in 1848, in which he said, "It is therefore apparent that the Safety Fund would have proved an ample indemnity to the bill holder had it not been applied to the payment of other debts of the bank than those due for circulation." By "other debts" Mr. Fillmore probably had reference to the guaranteeing of deposits. He believed that noteholders should be protected but not the ordinary depositors. White says, "If the people of New York had known at the

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[1] Knox, J. J., History of Banking in the United States.

beginning of this experiment all they knew at the end they would have made the Safety Fund liable only for the circulating notes."[1]

Another defect was the basis of contributions. The original law provided that "banks should pay into the bank fund from one half of one per cent of its paid up 'capital' each year."[2] The ratio of capital to circulation was not always the same with the different banks, and since the chief purpose of the law was to guarantee circulation, that should have been the basis of assessments for the contributions to the fund. It is a well known fact among economists that to tax a certain commodity tends to reduce the amount of that commodity. If note circulation had been assessed for contributions to the fund there would have been less notes in circulation, and this would have resulted in decreased losses from this source.

There were some defects in the application and administration of the new law which proved very costly. Over $700,000 was paid out of the fund for the redemption of fraudulent overissues of notes. This could have been avoided by proper state supervision and registration of note issues.

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1 White, Horace, Money and Banking.
2 Ibid.

Chapter III

Conditions Antecedent to the Rise of the Guaranty Movement In the West

It is the purpose of this chapter to give the reader a better understanding of the conditions in the banking business for a half century, or more, preceding the movement for the guaranty of bank deposits. There are certain phenomena in the development of American banking up to the eve of the guaranty movement that may lead one to ask: Is not the guaranty of bank deposits the next logical step? Let us now look into some of these developments and make an attempt to answer the above question.

1. State Regulation of Banks. Because of a lack of adequate statistics, we know very lettle about the management and condition of the early private banks before the development of the state and national banking systems. One of the first regulations under state supervision was the requirement of certain cash reserves for the redemption of bank notes. Our national banking laws of 1863 is another example of the requirement of cash reserves. In the case of reserves there are two forces working in opposite directions; the bank wants the reserve as small as possible, while the noteholder and the depositor want it as large as possible. The larger the bank's loans and the smaller its reserves the more profit it makes, while in the case of the depositor and the noteholder the larger the reserves the safer are their deposits and notes.

Another regulatory measure for the protection of a bank's cus-

tomers is the double liability law which was first introduced in this country as a part of our national banking law of 1863. Since that time the various states have made the double liability feature a part of their banking statutes. It provides that the owners or stockholders of a bank shall be liable to the creditors of the bank for double the face value of the stock held. The law makes depositors and noteholders preferred creditors.

Many other regulations have been imposed upon banks for the protection of its depositors. The limitation of the ratio of capital and surplus to deposits, the limitation of the amount of loans to bank officials, the prohibition of certain kinds of speculative investments, the minimum limitation as to the amount of capital stock a bank may have depending on the population of the community, and the limitations on the rate of interest paid or received are all examples of state regulation for the protection of customers. Most of these regulations have emerged within the past fifty years.

2. Growth and Importance of Bank Deposits from 1836 to 1900. As indicated in the preceding chapter, bank notes are used more extensively in proportion to population, in sparsely settled communities than in regions of dense population. As the population increases bank deposits increase, and as individual deposits increase, the demand for bank notes decreases. The table one the following page showing the development of banking in the State of New York from 1836 to 1860 will show this fact more clearly.

Table Showing the Number of Banks, Capital, Loans, Deposits, Note Circulation and Specie in the State of New York from 1836 to 1860[1]
(in Million dollars)

Year	Number of Banks	Capital	Loans	Deposits	Note Circulation	Specie
1836	86	31.3	72.5	19.1	21.1	6.2
1837	98	37.1	79.3	19.3	24.2	6.6
1838	95	36.6	61	15.7	12.4	4.1
1840	96	36.8	52	16.1	10.6	5.9
1843	137	43.4	61.5	27.4	17.2	11.5
1846	155	43	72	30.6	22.3	8
1849	192	45.5	90.2	38.2	24.2	8.1
1852	240	59.7	127.2	65	27.9	13.3
1853	280	79	145.9	78.1	32.6	14.1
1856	303	96.4	183.9	96.9	34	12.9
1857	311	107.5	170.8	83.5	27.1	14.3
1858	301	110.3	192.2	108.2	28.5	28.3
1860	306	111.8	200.1	116.2	31.8	21.7

A careful study of the table reveals some very important changes that took place in New York during the twenty-five year period, which in all probability is not unlike the changes that took place in the other states during that time. In the first place, the number of banks increased from eighty-six in 1836 to three hundred six in 1860,

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[1] Senate Document, Vol. 34, 61st Congress 2d Session, 1909-1910.

the increase being rapid and fairly regular. The capital increased rather slowly until 1850, then rapidly until the panic of 1857. The general trend of the movement of specie and loans was about the same as the increase in the number of banks. The chief purpose of the table is to show the changes that took place in regard to deposits. There was no noticeable increase in deposits until 1840, in fact they showed a decrease with the exception of the year 1837. In 1840 the total bank deposits in the State of New York amounted to 16.1 million dollars, but in 1860, only twenty years later, they amounted to 116.2 million dollars. This was an increase of over seven hundred per cent. In this same period the note circulation increased only fifty per cent. The ratio of note circulation to capital in 1840 was twenty-nine per cent, in 1860 the ratio was twenty-eight and one half per cent, showing a decrease in the twenty years of one half of one per cent.

The National Bank Act of 1863 was another step toward government supervision and the operation of banks. It provided a circulation based directly upon the securities and the guarantee of the United States Government. This provision was not altogether new and spontaneous, but was a result of varied experience in the United States as well as in the several states. To show the effect which the national banking system has had on banking development in the United States from 1863 to 1900, the table on page 27 has been prepared.

A noticeable feature of the table is the steady increase of the

Table Showing the Number of National Banks, Circulation, and Deposits of National Banks from 1863 to 1900[1]
(in million dollars)

Year	Number of Banks	Note Circulation	Deposits
1863	66		8
1865	1,513	171	500
1870	1,648	296	507
1875	2,086	314	618
1880	2,095	317	1,006
1885	2,732	267	1,111
1890	3,573	213	1,485
1895	3,706	185	1,720
1899	3,595	200	2,450

individual deposits. There is also a steady increase in the number of banks throughout the period, which suggests the soundness of the plan of government supervision and guaranty of note circulation. In regard to the ratio of deposits to note circulation, the same result is revealed in the case of the national banks as was shown in the case of the state banks of New York from 1836 to 1860, namely, that as deposits increase note circulation decreases. The outstanding notes of national banks began to decrease from 1880. In 1865 the ratio of note circulation to capital was 43 per cent, in 1899

[1] Knox, J. J., History of Banking in the United States, p. 293.

the ratio had decreased to 33 per cent. During the same period the ratio of deposits to capital increased from 127 per cent in 1865 to 405 per cent in 1899.

Sufficient accurate data for deposits in all state banks in the United States from 1863 to 1900 are not available, but Mr. Knox[1] gives us the following data regarding state banks in this period:

Table Showing Number of Banks, Capital Stock, Deposits, and Note Circulation of State Banks from 1863 to 1899
(Figures representing money are in million dollars)

Year	Number of Banks	Capital Stock	Deposits	Note Circulation
1863	1,466	405	393.6	238.6
1873	-----	42.7	110.8	2.
1883	754	102.5	335	2.
1893	3,579	250.8	709.9	-------
1898	3,965	233.5	912	-------

The table shows that deposits decreased about 280 million dollars in the ten year period from 1863 to 1873.. But it must be remembered that during the same period national bank deposits increased about 540 million dollars.[2] This must not be construed to mean that deposits in state banks decreased, but the apparent decrease is due to the fact that a large per cent of the 1,976 national banks in 1873, were in the state system previous to the passage of the National Bank Act. The sudden decrease of note circulation of state banks is due

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1 Knox, J. J., History of Banking in the United States.
2 Ibid.

to a ten per cent tax placed on note issue by an act of Congress, March 3, 1865. There was a rapid increase in deposits of state banks from 1873 to 1899 as shown by the table.

The number of state banks in the entire United States from 1877 to 1899 is given below:

State Banks In the United States from 1877 to 1899[1]

Year	No. according to Comptroller's Report	Approximately Correct Number
1877	592	823
1878	475	815
1879	616	814
1880	620	816
1881	652	820
1882	672	848
1883	874	937
1884	817	1022
1885	975	1120
1886	849	1214
1887	1413	1526
1888	1403	1732
1889	1671	2093
1890	2101	2552
1891	2572	3051
1892	3191	3457
1893	3579	3662
1894	3586	3767
1895	3774	3877
1896	3708	3937
1897	3857	4008
1898	3965	4215
1899	4191	4237

1 Senate Document, vol. 34, 61st Congress, 2d Session, 1909-10. The comptroller's report of the number of banks was made up incomplete data, the third column was taken from reports of state auditors.

3. Bank Deposits and Note Circulation from 1900 to 1910.

In the preceding paragraghs we have indicated the increasing importance of bank deposits as compared to note circulation. The note circulation of state banks has been practically eliminated by the ten per cent tax, but the deposits of these banks have kept pace with the deposits of national banks.

During the decade immediately preceding the guaranty movement, 1900 to 1910, deposits continued to increase at a very rapid rate, as is shown by the following table:[1]

Table Showing the Number of National Banks and Deposits in National and State Banks from 1900 to 1910
(Figures representing money are in million dollars)

Year	Number of National Banks	National Bank Deposits	National Bank Note Circulation	State Bank Deposits
1900	3732	2458	265.3	1266
1901	4165	2942	319	1610
1902	4535	3099	309.3	1698
1903	4939	3201	359.3	1814
1904	5331	3312	399.6	2073
1905	5668	3784	445.5	2365
1906	6053	4055	510.9	2741
1907	6429	4323	547.9	3068
1908	6824	4374	612.7	2937
1909	6926	4898	641.3	2466
1910	7145	5287	675.6	2727

It will be seen that during this period that deposits in both national and state banks more than doubled, thus continuing to show their increasing importance.

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[1] Statistical Abstract of the United States, 1926, pp. 265-61.

4. The Panic of 1893 and Its Results. No doubt the financial crisis of 1893, one of the worst our country has experienced, had its influence on the movement for the guaranty of bank deposits which started fourteen years after the panic. Knox says, "The United States Treasury had become almost the sole source of the immense volume of paper currency upon which the business of the country was done. The volume of the currency had become so great that the year commenced with great expectations of a business larger in volume and more profitable than ever before. In April, however, doubts began to be entertained of the power of the Government to maintain the gold payment of all this paper money when presented for redemption, and lack of confidence in the Treasury began to spread to the financial institutions of the country. The depositors in the banks became doubtful of their power to pay on demand, and began to draw out their deposits. Nor did they use the money so drawn in the usual manner by loaning it to others. The banks in their turn were unable to make loans to their customers who required money to carry on their business. The entire financial machinery became deranged, and business almost stopped."[1]

There were sixty-five national bank failures during the year. These banks had a capital investment of $10,900,000. Two hundred sixty-one state banks failed during the year with a capital involved of $16,641,637.[2] The amount owed to the depositors in the case of

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[1] Knox, J; J., History of Banking in the United States, p. 202.
[2] Ibid.

the state bank failures was $46,000,000, $17,000,000 of which was paid to the depositors upon liquidation. This amounted to a loss to depositors of about 63 per cent.

The evil effects of the panic of 1893 had not been entirely forgotten when the so called bankers' panic of 1907 spread terror over the entire country. Perhaps the banks in the agricultural sections of the West were hit harder than in any other place because they had sent their surplus funds to the banks of the large cities of the East for deposit. When the panic struck they could not pay the depositors except in small sums, $25 or $50 per week. This was the straw that broke the camel's back. The farmers of the West began to demand protection for bank deposits.

5. Political Agitation. Politicians were not slow in seeing an opportunity to take advantage of the depressed conditions caused by the panic of 1907. They saw that the advocacy of some sort of relief for the farmers of the great agricultural regions of the central-western states, would have a great influence on the voters of the section. The National Democratic Convention at Denver, 1908, adopted a plank in its platform to read as follows:[1] "We pledge ourselves to legislation by which the national banks shall be required to establish a guaranty fund for the prompt payment of the depositors of any insolvent national bank, under an equitable system which shall be available to all state banking

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[1] Outlook, 1908, 90:60-61.

institutions wishing to use it." The Republican party, under the leadership of Mr. W. H. Taft, recognizing the popularity of the guaranty idea, also included a plank in its platform supporting the guaranty plan, but in a modified form, making the guaranty of bank deposits voluntary instead of compulsory.

The agitation for some form of insurance to protect depositors was not confined to national politics, but candidates for state offices based their campaigns on the principles of the guaranty of deposits. Governor Leedy of Kansas, 1907-08, was a Populist and a strong enthusiast for the guaranty of bank deposits. Mr. J. W. Breidenthal, also a Populist, was bank commissioner at that time, and in his Report of September 1, 1908, highly recommended a guaranty law.

Chapter IV

Summary of the Guaranty Laws of Various States

Since the panic of 1907, eight states of the union have enacted laws for the purpose of guaranteeing bank deposits. Oklahoma, the newest state in the union, took the lead by passing the first guaranty law, December 17, 1907. Kansas, Nebraska, and Texas followed in the order named in 1909; Mississippi in 1914; South Dakota in 1915; and North Dakota and Washington in 1917. Many other states have made unsuccessful attempts at depositors' guaranty legislation. Colorado, Missouri, Iowa, Minnesota, and others are numbered among the unsuccessful.

We shall now take up the study of the laws of the various states in the order of enactment.

1. The Guaranty Law of Oklahoma--1907. The Oklahoma law was passed in the first year of her statehood, taking effect in February, 1908. As originally passed the law was extremely crude and it was soon found that radical amendments were necessary. The provisions of the law made it obligatory upon all state banks to become members and to operate under its provisions. National banks of the state were permitted to avail themselves of the protection of the depositors' guaranty fund, by applying to the state banking board, provided their applications were accepted. Trust companies were also permitted participation.

To provide a fund for the guaranty of deposits of failed banks

an assessment of one per cent of average daily deposits was levied against state banks. Deposits of the United States and state funds were not included in determining the average daily deposits. In this connection it was also provided that the state banking board, which at that time, was composed of the governor, the lieutenant governor, the president of the board of agriculture, the state treasurer, and the state auditor, should keep the fund up to one per cent of the total deposits of all participating banks and trust companies. Special assessments to cover deficiencies, should a deficiency occur, should be collected from time to time as might be needed. There was no limit to the special assessments which the state banking board might levy and collect. All banks and trust companies organized subsequent to the enactment of the law should pay into the depositors' fund three per cent of the amount of their capital stock, when they opened for business.

The original law provided protection to all classes of deposits, but later was amended so as to exclude from protection all deposits otherwise secured.[1] The amendment also provided that no deposit in any state bank on which a greater rate of interest is allowed or paid, either directly or indirectly, than is permitted by the rules of the bank commissioner, shall participate in the benefits of the guaranty fund.[2]

Some important changes were made in the amendment of June 11,

1 Banking Laws of the State of Oklahoma, Section 49.

2 Ibid.

1909. It provided that the guaranty fund should consist of five per cent of the average daily deposits instead of the original one per cent. The assessment was to be one per cent of deposits the first year and one fourth of one per cent each year thereafter until the five per cent fund was accumulated. The amendment of March 6, 1913 reduced the guaranty fund from five per cent to two per cent of average daily deposits. The amendment of June 11, 1909 limited the extra assessment of any one to two per cent of the average deposits. This latter amendment, March 6, 1913, removed one of the worst dangers of the law, that of unlimited assessments. It also provided that the annual assessment should be one fifth of one per cent of average deposits, and not more. During the three years of 1914, 1915 and 1916 the state banking board could also levy an extra assessment of one fifth of one per cent, but after that time no more extra assessments were permitted.[1]

If at any time the guaranty fund and special assessments failed to meet the losses of deposits of failed banks, the banking board should issue to unsatisfied depositors certificates of indebtedness bearing six per cent interest. As the fund accumulated from regular annual or special assessments these certificates were called in and paid.

The original act did not make any provisions as to how the fund was to be kept, but the amendment of June 11, 1909 provided that seventy-five per cent of the fund should be invested in state warrants or

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1 Banking Laws of the State of Oklahoma, Section 48.

other similar securities. The remaining twenty-five per cent was to be held by the banking board as a ready cash reserve. In 1911, a second amendment permitted state banks to pay their assessments in non-interest bearing cashiers' checks to be held by the banking board until needed. Thus the banks were allowed the use of their assessments until needed by the board. As security for its liability for assessments to the guaranty fund each bank is required to deposit with the banking board bonds or warrants equal to one per cent of its deposits, but in no instance must the security be less than five hundred dollars.[1]

Another important change was made concerning the membership of the state banking board. Originally the banking board that administered the new law was composed of the governor, the lieutenant governor, the president of the board of agriculture, the state treasurer, and the state auditor. As the composition of this board was purely political, more or less politics entered into and hindered the smooth working of the law. When losses had begun to threaten, the state banks demanded a change. They desired that the board be placed in the hands of the bankers themselves, and if their proposal was granted, they agreed to serve without pay. The state legislature accepted the proposal of the bankers in an amendment of March 6, 1913. According to the amendment each bank was to have one representative in the State Bankers' Association. The association

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[1] Banking Laws of the State of Oklahoma, Section 48.

selected a council of from nine to fifteen members. This chosen council recommends nine persons to the governor from which he selects three members of the banking board. The three persons chosen, the bank commissioner, and the assistant bank commissioner constitute the banking board.[1]

The state board or bank commissioner supervises and controls the guaranty fund and adopts all necessary regulations not inconsistent with the law for the administration of such fund. The board may also issue warrants when the fund is insufficient to pay the depositors of the failed banks. The bank commissioner is authorized to take charge and wind up the affairs of insolvent banks.[2]

2. The Guaranty Law of Kansas--1909. The period from about 1880 to 1887 was very prosperous for Kansas and the neighboring states. Then came a series of crop failures at a time when farm products were worth less than the cost of production. Next followed the national depression of 1893. In 1891 Kansas passed a general banking law, and for the first time banks of Kansas were regulated by law.[3] Prior to the enactment of the general banking law, the privately owned banks were a sort of loan or real estate company. They bought a lot of real estate during the boom days from 1880 to 1890, and during the depression of 1893, found themselves overloaded with unsalable property. In the six year period of 1892 to 1898,

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1 Banking Laws of the State of Oklahoma, Section 48.
2 Ibid. Section 41.
3 Second Biennial Report of the State Bank Commissioner.

seventy-five state banks of Kansas suspended payment. Thirty-two national banks failed in the decade from 1890 to 1900, causing a loss to depositors of over nine hundred thousand dollars.[1] Remedial legislation was sought and representative F. P. Gillispie introduced the first bank guaranty bill in 1897. The bill did not arouse much enthusiasm, perhaps due to an era of returning prosperity.

J. W. Breidenthal, a Populist bank commissioner, urged a guaranty law in his report of 1898. Governor Leedy, a Populist, was governor at that time, but was defeated by the Republicans in the election of 1898. Before relinquishing control Governor Leedy called a special session of the legislature in 1898 and made a last desperate effort to secure the passage of a guaranty law. The bill provided that state banks either donate one eighth of one per cent of deposits to a guaranty fund, or turn five per cent of their deposits over to the state treasurer, and the interest on this amount was to go into a guaranty fund.[2] The bill passed the Senate and lacked only four votes passing the House of Representatives.

Governor Stanley, the new Republican governor, in his first message recommended the passage of a guaranty law for the protection of bank depositors. The legislature gave no response to the suggestion and no more was heard of it for ten years.

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1 Report of the Comptroller of the Currency, Vol. 2, p. 114.

2 Topeka Daily Capital, September 5, 1909.

After the Oklahoma law went into effect in February, 1908, Kansas revived her interest in such a law. The banks in the southern part of the state feared that deposits would be attracted to the Oklahoma banks where deposits would be protected.

A plank in the Democratic platform of 1908 favored the idea of the guaranty of bank deposits. The movement gained considerable popularity during the summer, and in July the Republican State Council met at Topeka and went on record as approving the idea. The Republicans were successful in the November election. Since both parties had pledged their support of such a law, there was nothing to do when the legislature met in January, 1909, but turn attention to the details of the law that was to be enacted.

With little difficulty the legislature of Kansas passed a depositors' guaranty law, March 6, 1909, to take effect June 30th. One of the outstanding features of the Kansas law is that participation is optional with the banks.[1] A bank may or may not take advantage of the law, just as it chooses. Any bank doing business in the state with an unimpaired surplus of ten per cent of its capital, and having been in the banking business at least one year, may come under the protection of the guaranty law after getting the approval of the bank commissioner.

Another distinguishing feature of the guaranty law of Kansas is

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[1] Cooke, Thornton, Quarterly Journal of Economics, 24:85.

found in the method of paying depositors of failed banks. In Oklahoma depositors are paid immediately after failure, but in Kansas the bank commissioner issues a certificate of deposit to the depositors of failed banks. The certificates are called in and paid by the bank commissioner from the liquidated assets of the failed bank. If the assets of the insolvent bank are not sufficient to pay the certificates then the payments are made from the guaranty fund. If the guaranty fund is insufficient to meet all liabilities to depositors, the payments are made pro rata, the balance being paid when regular or special assessments have recouped the guaranty fund.[1]

The law provides for an annual assessment of one twentieth of one per cent of average daily deposits, less capital and surplus. The minimum assessment is $20. The regular annual assessment is to continue until the guaranty fund reaches $50,000, after which it is discontinued until the fund falls below that amount. If the fund should become exhausted the bank commissioner may levy additional assessments of one twentieth of one per cent, provided no more than five such assessments are levied in any one year.[2]

The law as passed in 1909 restricted the guaranteed deposits to those not bearing interest, to time certificates not bearing a higher rate than three per cent, and to savings accounts of not more than $100 to any one person. The law as it now stands protects all deposits not otherwise guaranteed. Another amendment changed the

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1 Bank Depositors' Law, Section 4.

2 Ibid., Section 3.

rate of interest which might be paid on guaranteed deposits. At first the rate was fixed at three per cent. This proved unsatisfactory to banks in the guaranty system because of different economic conditions in different parts of the state. In some localities four per cent was not a high rate, but in others it was. The law as amended give the bank commissioner authority to fix the rate, which ranges from three to five per cent.

The Kansas law permits national banks to participate in the guaranty system provided they meet the state requirements. But Attorney General Wickersham gave the same ruling as did his predecessor in the Oklahoma case. He ruled that a national bank had no corporate power to submit to state regulation, and that only an act of Congress could confer such power.[1]

3. The Guaranty Law of Nebraska--1909. About three weeks after the Kansas guaranty law was enacted the Nebraska legislature passed a similar measure. However, the Nebraska legislation resembles Oklahoma's law more than it does that of any other state. It is compulsory for all state banks. A guaranty fund is to be created equal to one half of one per cent of deposits. When the fund reaches that amount no more assessments are made until it is depleted below one half of one per cent of deposits. For the first two years there shall be four semiannual assessments of one fourth of one per cent of average daily deposits not otherwise secured. Regular assessments

[1] Outlook, Vol. 97, January 14, 1911.

following the initial two year period shall be one tenth of one per cent. Special assessments may be made in any one year not to exceed one per cent.[1]

New banks organized after the law takes effect are required to pay into the guaranty fund four per cent of their capital stock when they open for business. This amount is adjusted later on the basis of the average daily deposits. The first two semiannual assessments plus the four per cent of capital contributed must equal at least one per cent of average daily deposits as shown by the first two semiannual statements.[2]

Some special features of the Nebraska law will be considered next. In the first place, the affairs of the insolvent banks are wound up through a receivership court instead of by the bank commissioner as is the case in Oklahoma and Kansas. Under the receiver the assets are liquidated as soon as possible, and often at considerable expense, while in Oklahoma and Kansas the bank commissioner may operate the bank for awhile until it gets in better financial condition. No provision is made for the issuance of interest-bearing certificates.

A few amendments have been made. The original law prohibited the investments of a bank beyond eight times its capital and surplus. This ratio proved to be burdensome and was changed to a ratio of ten instead of eight times capital and surplus. No mention was made of the security which guaranteed banks were to give for public deposits.

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1 Cooke, Thornton, Quarterly Journal of Economics, 1909, 24:85.
2 Federal Reserve Bulletin, September, 1925, p. 637.

In 1911 an amendment profided that a bank which had met all of the requirements of the law did not have to give additional security.[1]

4. The Guaranty Law of Texas--1909. Perhaps some rather unusual circumstances in connection with the history of banking in Texas should be reviewed before attempting to outline her guaranty law. On February 5, 1844, an act passed by the Congress of the Republic of Texas was approved providing "that all laws, granting to any individual, individuals or corporations, the authority to issue either bills or promissory notes, to pass and circulate as money, is hereby repealed, and the authority to issue other bills or promissory notes, or any other instrument in writing, in print, hieroglyphics or engravings to circulate as money is hereby abridged."[2] The constitution of 1845 prohibited any corporate body from exercising banking privileges under the laws of Texas. The attitude of Texans in regard to banking institutions was no doubt a result of the Jacksonian theory of banks. That theory was that banks were a sort of swindling institution to enrich a few persons and ruin many.

Under the authority of the reconstruction act of 1869, Texas adopted a new constitution, but omitted the section in regard to state banks. Under that constitution state banks were not prohibited or approved, not mention being made of them in any way. When the state was again admitted to the union in 1876, the sections of

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1 Cooke, Thornton, Quarterly Journal of Economics, 1913, 28:100.
2 Robb, Thomas F., Guaranty of Bank Deposits, p. 145.

the old constitution of 1845, prohibiting state banks were promptly adopted. It was not until 1904 that Texas permitted state banks. So the banking system of Texas was comprised of national banks.

In 1908 the state Democratic organization pledged itself to support the popular guaranty idea, as had the national Democratic convention at Denver. When the legislature met in 1909 many of the members had forgotten their pledge, and after a stormy session of three months no guaranty law was passed. Governor Campbell called a special session in April, but the legislature was so divided that nothing was accomplished. Officials of national banks objected to the law, saying that it would be unfair to them for Texas to create new banks and then guarantee the depositors, after having forced banks before 1904 to enter the national system.

After months of wrangling a compromise law was finally passed August 9, 1909. It provided that all deposits must be protected by one of two methods: the Depositors' Bond Security System, or the Depositors' Guarnty Fund. If a bank chose the former method it was required to file with the bank commissioner a bond or other guaranty of indemnity equal to the amount of its capital stock. The security had to meet the approval of the bank commissioner.

In 1922 only thirty-three banks out of the nine hundred state institutions had elected to use the bond security method of protecting depositors.[1]

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[1] Federal Reserve Bulletin, September, 1925, p. 633.

Banks and trust companies electing to use the Depositors' Guaranty Fund were required to deposit with the state banking board one per cent of the average daily deposits of the preceding year. Subsequent annual assessments were to be one fourth of one per cent of average daily deposits until the fund equaled $2,000,000. If the fund is depleted or an emergency arises the state banking board may make special assessments not to exceed two per cent of average daily checking deposits in any one year.[1]

New banks formed since the inauguration of the system are required to pay an assessment of three per cent of capital and surplus, subject to adjustment on the basis of their deposits as provided for banks already existing at the end of the year.

Upon failure of a bank depositors are to be paid at once out of the cash of the failed bank. If there is not enough cash available to meet all claims the balance is to be paid out of the depositors' guaranty fund.

One fourth of the guaranty fund is paid in cash to the state banking board by the contributing banks. The banking board in turn deposits this cash with the state treasurer for safe-keeping. The remaining three fourths is credited to the state banking board on the books of the contributing bank, subject to check by order of the banking board.[2]

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1 Federal Reserve Bulletin, September, 1925, p. 637.

2 Ibid.

5. Guarnty Fund Laws of Other States. Mississippi was the fifth state to pass a law guaranteeing deposits. Such a law was passed March 9, 1914. Thornton Cooke[1] gives us a splendid picture of the conditions in Mississippi immediately preceding the passage of the banking law:

"It may seem a far cry from the boll weevil to deposit guaranty. But remembering the relation of the chinch bugs in the Missouri Valley to the free silver movement in the nineties, one realizes that an insect may be a cause of financial legislation proposed or enacted. For several years, in Mississippi south of the 33d parallel, the cotton crop has been almost destroyed by the boll weevil. In a typical county, Pike, the normal crop of 25,000 bales fell to 3,600 bales in 1913. In other sections of the state the crop was injured by the army worm, and in the Delta section by overflows from the Mississippi River. At the same time the state banks were running without supervision. The statutes were not entirely lacking in banking provisions, and some of the provisions were in themselves very good, but there was no bank examination and no verification of reports. 'In a word', says a Mississippi legislator, 'Mississippi state banks were simply chartered by the state and turned loose to do business just as they would.'

"It is inevitable that many banks should fail. There is no official list of the failures, but a list privately compiled showed 22 failures in 1912 and 1913 and 7 more early in 1914. The deposits

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[1] Cooke, Thornton, Quarterly Journal of Economics, 1914, 29:419.

were not ascertained in all cases; so far as known, they amounted to $4,600,000. The number of banks reporting to the state auditor fell from 342 in June, 1911, to 306 in June 1914. National banks increased in number from 31 to 37 . There was an attempt in the legislature of 1912 to enact a banking law. It failed largely because the Senate and House could not agree on the methods of selecting bank examiners. A majority of the Senate wished the examiners to be appointed, while the House wanted them elected by popular vote.

"By 1914 it was evident that something must be done. There was a bank failure just as the legislature met, and failures occurred all through the session. Not satisfied now with a bill for safeguards and supervision, many legislators insisted from the start on the guaranty of bank deposits. The Mississippi Bankers' Association, with much the same arguments that had been used before the legislatures of other states opposed the guaranty section to the end. It is possible that if the members of the Association had foreseen the ultimate adoption of deposit guaranty, they would have made participation optional with the banks, and could have provided for appointive, instead of elective, bank examiners. After a long struggle a bill was finally passed in March and was signed by the governor March 9."

It is interesting to note that the Mississippi guaranty law is almost identical with the Kansas law. There are, however, two

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important differences. In Mississippi all state banks are compelled to join the guaranty system, while in Kansas participation is voluntary. Perhaps the most unusual feature of the law is the method of selecting bank examiners. The state is divided into three districts corresponding to the three districts of the supreme court. One examiner in each district is elected by popular vote. Before a person can become a candidate for bank examiner, he must pass a satisfactory qualifying examination given by a board of three bank commissioners. The examining board is created by appointment, "One is appointed by the governor who shall be a successful banker and business man, one by the attorney-general, who shall be an experienced lawyer; and one by the auditor, who shall be an experienced accountant."[1]

If the applicants pass a satisfactory examination making a grade of at least 75 per cent, a license to become a candidate is issued to them by the board of examiners.

The guaranty provision was made obligatory for all state banks, but they were not compelled to come in under the system until May 15, 1915, fourteen months after the passage of the act. This gave banking board time to examine all banks thoroughly.

Each bank must deposit and maintain with the state treasurer as evidence of good faith, bonds or other acceptable securities to the amount of $500 for every $100,000 or fraction thereof of

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[1] Mississippi Banking Law, Section 4.

its average daily deposits eligible to guaranty less capital and surplus.[1]

The Mississippi law provides for an assessment for the guaranty fund of one twentieth of one per cent of average daily deposits less capital and surplus. Four additional assessments at the same rate may be made annually, if needed. When the guaranty fund reaches $500,000 or more assessments cease until the fund is depleted below that amount. The state treasurer holds the guaranty fund subject to the order of the superintendent of banks, and when the fund amounts to $10,000 or multiples of $10,000 the state treasurer may, at the option and order of the superintendent of banks, invest the fund in certain securities.

In South Dakota as in many other states of the west and south, the Republicans and Democrats pledged themselves in the 1908 campaign, to attempt some sort of guaranty legislation. Before the legislature met the following year, banks had developed considerable opposition to any system of deposit guaranty. But to meet campaign pledges something had to be done, so a voluntary law was enacted. Two provisions kept it from taking effect. One hundred banks must signify their intention of operating under the law before it could be put into effect. Another difficulty was a high membership fee required before entering the guaranty fund system.

In the next three years fourteen banks failed within the state

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1 Federal Reserve Bulletin, September, 1925, p. 638.

of South Dakota with estimated losses from thirty to thirty-five per cent. In the meantime Nebraska was having apparent success in the working of her guaranty law. These bank failures and the successful operation of the law in Nebraska spurred the South Dakota legislature to action, and in March, 1915 a new law was enacted.

The new guaranty law of South Dakota was very much like that of Nebraska, the one that had been watched so closely for the past few years. The law is compulsory for all state banks. All deposits not otherwise secured are protected. The annual assessment is one fourth of one per cent of average daily deposits. When the fund has accumulated to an amount equal to one and one half per cent of deposits, the assessments cease until the fund is depleted to one per cent of deposits.[1] Any bank organized after the law goes into effect is required to pay into the guaranty fund four per cent of its capital stock, subject to adjustment after the first two assessments on a footing equal with the banks already under the system.[2]

A distinctive feature of the South Dakota law is that it does not provide for extra assessments. If the guaranty fund is depleted and there are depositors having claims against the fund, the superintendent of banks may issue seven per cent interest-bearing certificates in favor of the failed bank. These certificates are sold and the proceeds paid to depositors. Another method of payment of depositors' claims is for the superintendent of banks to issue five

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1 Federal Reserve Bulletin, September, 1925, p. 638.

2. Ibid.

per cent interest-bearing certificates to depositors. The assumption is that over a long period of time the one fourth of one per cent will take care of all losses. In the history of national banking over a period of forty-three years the losses equaled to only one twentieth of one per cent of deposits.

On March 10, 1917 two other states enacted laws for the protection of depositors of state banks, namely, North Dakota and Washington.

In North Dakota as in South Dakota and Nebraska, the depositors' guaranty law is compulsory. All state banks must qualify and pay assessments or quit business. The law is administered by the guaranty fund commission, composed of the governor, the state examiner, and three others appointed by the governor. A person to be eligible to appointment on this commission must have had at least five years' experience in practical banking in North Dakota, and must be a bank official at the time of appointment.[1]

The annual assessment is one twentieth of one per cent of average daily deposits. All persons are protected unless secured in some other way. The annual assessments continue at one twentieth of one per cent until the fund equals one per cent of deposits. Should the fund become depleted below three fourths of one per cent of deposits, because of a series of bank failures, as many as four special assessments may be made in any one year, at the same rate as

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[1] North Dakota Depositors' Guaranty Law, Section 1.

the regular assessments.

The guaranty fund commission does not have the custody of the fund, but it is kept by the banks themselves. The commission notifies each bank of its share of the assessment, and then the bank places this amount to the credit of the commission subject to payment on demand. No bond or security of any kind is required of the banks.

The procedure in case of bank failure is as follows. First, the examiner determines the amount due each depositor. Second, he determines the proportional share of the loss that each bank will have to pay. These figures are certified to the guaranty fund commission. Third, the treasurer of the commission draws against the solvent banks and pays the depositors of failed banks. In case of a deficit in the fund five per cent interest-bearing certificates are issued in favor of the insolvent bank, due on the first day of the following March. These certificates are paid out of the first money accruing to the fund.

Out of the eight states that have enacted laws guaranteeing deposits, only two were in scattered section of the country. Mississippi is the only example east of the Mississippi River, and Washington, in the far Northwest is the other isolated example. We shall now turn to the consideration of the Washington Statutes.

To a great extent Washington patterned after the Kansas law.

As in Kansas the law is voluntary. Banks may enter or withdraw from the system as they please. The administration is in charge of the guaranty fund board, composed of the governor, the state examiner, and three members appointed by the governor. The administrative section evidently was taken from the North Dakota Law. Before a bank is admitted to membership it must have an unimpaired supplus of at least ten per cent of its capital stock.

The guaranty fund consists of the total of one half of one per cent of the average daily deposits eligible to guaranty of member banks. As security for the payment of assessments member must deposit securities to the face value of $1,000 for every $100,000 of deposits.[1] If the fund should be reduced by more than one fourth of this amount, the guaranty board shall determine whether or not to make an assessment on the member banks. When assessments are made they must not total more than one half of one per cent of average daily deposits in any one year.[2]

When a bank become insolvent, the state bank examiner takes charge and issues warrants to unsatisfied guaranteed depositors. These warrants are due at once if sufficient funds are available for their redemption. If the fund is depleted the warrants bear interest at the rate of five per cent until paid.

Thus far we have been dealing with the depositors guaranty laws of the various states. We shall next consider some of the experi-

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1 Guaranty Fund Act of the State of Washington, Section 3.
2 Ibid.

ences in the administration and the application of the law with a view to the determination of the success or failure of the plan of guaranteeing deposits.

Chapter V

The Operation of the Guaranty Law in Oklahoma

1.. Why Oklahoma Was First to Experiment with a Guaranty Law. Much of the agitation for depositors' guaranty laws, when the movement was at its height, may well be assigned to political reasons. Many candidates for state offices in the middle western states advocated bank deposit guaranty as a means of getting more votes. But in Oklahoma economic conditions was the chief motive prompting the movement. A good description of the conditions in Oklahoma at the time of the passage of the law is given by A. Piatt Andrew:[1]

"The idea (the guaranty law) was born in Oklahoma in the very throes of the panic of 1907, after the shortest possible period of gestation. The panic, it will be remembered, began October 28, 1907, and it was not until three weeks later, on November 16, that Oklahoma became a state, and that its first legislature began its sessions. Neverless the panic was not yet over; currency was still at a premium and clearing-house certificates were still outstanding throughout the country when the Oklahoma legislature passed its famous law. The first legislature of a new state had been in session only four weeks when, on December 17, it adopted with scarcely any debate a law without precedent in any other country, and with but one dimly remembered, unsuccessful prededent in the United States--a law which nevertheless presented what was probably the most far-

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[1] Yale Review, July, 1913, p. 600.

reaching and drastic experiment in banking legislation that had been made anywhere in the world for at least two generations."

Many people had suffered losses from bank failures and others had had the experience, in the latter part of 1907, of not being able to withdraw deposits which they had on their checking account. Country banks of the West had been in the habit of sending large amounts of surplus money to banks in the large eastern cities, such as New York, Boston, and Philadelphia. The small banks could find a market in the large cities of the industrial centers for the surplus money resulting from the harvesting of bounteous crops. The money would be returned gradually during the winter and spring months. When the financial panic came in October, 1907, many of the small banks in Oklahoma had large amounts on deposit in the eastern banks. Since the country banks could not get the funds from the eastern banks for some time, due to the panic, many of them were not able to meet the demands of their depositors. These depositors began to question the right of a bank to take their funds and invest them for the profit of the bank, and withhold a share of them from depositors in time of crisis. Naturally the depositors felt that they had a right to collect one hundred cents on the dollar on demand for demand deposits. The result was a movement to require banks to guarantee deposits.

It has been attempted to show that economic conditions culminating in the panic of 1907 was the chief cause of Oklahoma's radical move for banking reform. Another condition that no doubt had

its influence, was that Oklahoma was a frontier state. It had been in the union only thirty days when the depositors' guaranty law was passed. A pioneer state frequently indulges in experimental legislation. Politicians in a pioneer state seldom have either riches or reputation to lose.

2. The Law in the Courts. The Oklahoma law permitted national banks to enjoy its privileges, and with the guaranty idea so popular, national banks felt that unless they joined the system, the state banks would have an advantage over them. August 1, 1908, fifty-seven national banks had made known their wishes to comply with the depositors' guaranty law and accept its protection.[1] It was on the above date that Attorney-General Bonaparte handed down an opinion denying national banks the right to participate in the guaranty law. He held that the Oklahoma law required the bank to guarantee the obligation of a third party, and that the national banking law denied national banks that privilege. The Attorney-General's ruling caused no little excitement among the national banks, and many of them, while not approving the guaranty principle gave up their national charters and reorganized as stste banks so as not to be in competition with the new popular law.

The first case that came to the attention of the courts was the Noble State Bank. It asked the district court of Logan County to enjoin the state banking board from levying the first assess-

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[1] First Annual Report of the Bank Commissioner, 1908.

ment. The Noble State Bank claimed, first, that it was solvent and did not want to contribute to the guaranty fund, second, that the law was unconstitutional because of article I, section X, and the fourteenth amendment to the Constitution. The district court denied the injunction and an appeal was taken to the Supreme Court of Oklahoma. On September 11, 1908, the Supreme Court gave a unanimous decision approving the action of the lower court.[1] The case was then appealed to the United States Supreme Court. After going through all of the formalities of court procedure, an opinion was handed down on January 3, 1911 by Justice Holmes, all judges concurring, upholding the action of the Supreme Court of Oklahoma. Justice Holmes said, "The substance of the plaintiff's argument is that the assessment takes private property for private use without compensation. And while we should assume that the plaintiff would retain reversionary interest in the contributions to the fund, so as to be entitled to a return of what remained of it if the purpose were given up, still there is no denying that by this law a portion of its property might be taken without return, to pay the debts of a failing rival in business. Nevertheless, notwithstanding the logical form of the objection, there are more powerful considerations on the other side. In the first place, it is established by a series of cases that an ulterior public advantage may justify a comparatively insignificant

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1 Journal of Political Economy, 1911, 19:131-33.

taking of private property for what, in its immediate purpose, is a private use. And in the next, it would seem that there may be other causes besides the everyday one of taxation, in which the share to each party in the benefit of a scheme of mutual protection is sufficient compensation for the correlative burden that it is compelled to assume. At least if we have a case within the reasonable exercise of the police power as above explained, no more need be said."[1]

3. Effects of the Guaranty Law on Banking in Oklahoma. The Oklahoma guaranty law went into effect on February 14, 1908, and the International State Bank of Colgate failed on May 21st of that year. This was the first bank to close under the new law. Deposits in the bank at the time of the failure were $36,744.93. The state banking board paid the depositors at once, having to draw on the guaranty fund for $24,843.73. When the assets of the bank were liquidated the guaranty fund was reimbursed in full.

It has already been indicated that politics had no great influence in the passage of the guaranty law in Oklahoma. This can not be said, however, of the administration of the law, for the law itself provided that it should be in charge of the political party in power, the governor, the lieutenant governor, the presedent of the board of agriculture, the state treasurer, and the state auditor. The feeling is quite prevalent in Oklahoma that the International

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[1] Noble State Bank vs Haskell, 219 U. S. 112, 116-17.

State Bank of Colgate was closed for political reasons only. Dr. L. A. Conner, its president, said regarding the closing of the bank: "I never will believe anything else but that my bank was closed by Bank Commissioner Smock on telephone orders from Governor Haskell for no other purpose than to make a demonstration of the depositors' guaranty law for the National Democratic Convention at Denver."[1]

The bank failure that had the greatest effect was the Columbia Bank and Trust Company of Oklahoma City. It was the largest bank in the state and its failure almost wrecked the guaranty system. This bank had made a tremendous growth during the year immediately preceding its failure which occurred September 28, 1909. Dr. Thomas F. Robb gives us the following figures in regard to its growth: "On September 23, 1908, its deposits amounted to $365,686. By February 5, 1909, they amounted to $1,111,864.64, and on September 1, 1909, they were $2,806,008.61. Thus in a little over eleven months its deposits had increased by nearly seven hundred per cent."[2] There is a question as to whether this tremendously rapid growth was due to the new guaranty law or to some other cause. Many students of the history of the guaranty law seem to think that the law encourages speculation and wild-cat banking. The public appears to be somewhat indifferent to the actions of unscrupulous banking officials, when operating under the guaranty law. The theory is that

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1 First Annual Report of the Bank Commissioner, 1908.

2 Robb, Thomas F., Guaranty of Bank Deposits. p. 45.

since depositors are protected from loss they are not interested in the prosecution of crooked officials.

At the time of failure the Columbia Bank and Trust Company had $28,000 in cash and $185,000 in sight exchange. The guaranty fund had $300,000, $50,000 of which was in the Columbai Bank when closed. With over $2,800,000 due depositors, and less than $500,000 available from the funds of the the defunct bank and in the guaranty fund, it appeared to be an impossibility to carry out the law by paying depositors at once. Governor Haskell, an ardent supporter of the law, as head of the banking board, made a desperate effort to make a good showing for the new law. During the night following the closing of the bank, he borrowed about $450,000, and next morning September 29, 1909, when the bank commissioner opened the doors of the bank to pay depositors, as required by law, he had about one half million in ready funds plus the assets of the failed bank, of which one million ultimately proved to be worthless. Discrimination in paying depositors resulted. Over one million owed to one hundred nineteen country banks outside of Oklahoma City was not paid in full; some assets of the failed bank being turned over to the country banks as part payment on their claims. One month after the failure, October 30, 1909, $411,000 of deposits remained unpaid. By December 15, 1910, fourteen months after the failure, $11,256.79 of depositors' claims remained unpaid.[1]

There seems to have been considerable political scandal connected with the liquidation of the Columbia Bank and Trust Company. It

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[1] Statement of Bank Commissioner, October 30, 1909.

was so carelessly and hastily done that no accurate records of the proceedings could be found. National banks claimed that the banking board, with Governor Haskell at its head, had cooperated with the bank officials in attempting to cover up some of the evil effects of the failure and make it appear that the guaranty law was working satisfactorily. Governor Haskell was accused of shielding criminals by preventing an immediate investigation of the whole affair.

We shall not go into the details of the various bank failures in Oklahoma, but merely attempt to give a general summary of the banking activities during the life of the guaranty law from February 14, 1908 to March 31, 1923, when the law was repealed by an act of the legislature.

In order to show the number of failures under the guaranty system, the deposits in the banks at the time of failure, and the assessments for the guaranty fund, the following table[1] is submitted:

State Bank Failures in Oklahoma and Assessments Under the Guaranty Law

Year	Number of Failures	Capital	Deposits	Assessments
1908				$198,836.63
1909	3	$230,000	$1,575,000	327,387.68
1910	2	55,000	205,000	285,433.44
1911	8	203,000	1,058,000	600,537.52
1912	4	65,000	372,000	511,054.04
1913	16	414,000	1,745,000	201,824.66
1914	5	105,000	398,000	148,084.00
1915	5	75,000	312,000	161,817.29
1916	1	10,000	40,000	89,963.65
1917	2	20,000	85,000	133,355.69
1918	3	150,000	1,199,000	208,800.00
1919	5	90,000	803,000	231,962.00
1920	8	155,000	1,585,000	301,658.00

[1] Federal Reserve Bulletin, September, 1925, p. 630.

According to the figures given in the table an average annual assessment of about three per cent of capital stock was necessary to produce the collections for the guaranty fund. The total assessments equal to thirty-six per cent of the capital stock. The year 1916 was expecially trying for the guaranty system, with sixteen bank failures during the year. At one time during the year there was over $400,000 of guaranty fund warrants outstanding. On September 30, 1914, the fund was in debt $807,475.09; by December 31, 1916, the debt of the fund had been reduced to $666,378.51; on March 1, 1920, all outstanding warrants had been paid and there was $75,000.00 in the treasury. At this last date the future of the guaranty system looked very bright. The catastrophe that was to befall the guaranty system in Oklahoma within the next two years was little suspected.

The business depression beginning in 1921 and poor crops in Oklahoma that year caused 27 bank failures, all of which were state banks under the guaranty system. After the results of the first 13 of the 27 failures had been carefully checked the condition of the fund was summarized by Thornton Cooke:[1]

Warrants outstanding.....	$2,196,000
One half of deposits of other failed banks (estimate).....	1,158,000
Liabilities of the fund.....	3,354,000
Interest at 6 per cent.....	201,340
Due depositors of failed banks.....	3,555,340

The last 14 bank failures in 1921 were not taken into consideration

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1 Cooke, Thornton, Quarterly Journal of Economics, 1923, 38:112.

in computing the above table, except the second item of the estimated deposits in the last 14 failures.

The depcsits subject to assessment for the fund were $156,000,000, and the maximum assessment of one fifth of one per cent would procuce annually $312,000. This would leave to apply on the principal only $111,000 per annum. The Bank of Commerce of Okmulgee failed November 1, with deposits of $1,732,540. From the above figures it would be at least twenty years before any payments could be made to the Okmulgee depositors.

The conditions were made still worse during 1922 with 32 state bank failures. Deposits in these 32 banks amounted to $7,230,000, The situation was now impossible. The depositors of failed banks tried to persuade the legislature in January, 1923, to raise the assessment from one fifth of one per cent to one per cent. Bankers seriously opposed this because it would equal to ten per cent of the capital stock. A bill was introduced later providing for the issuance of bonds to pay off depositors, but much opposition was expressed by the tax payers and the bill was lost.

The law was finally repealed by the legislature, taking effect March 31, 1923.

The guaranty system in the fifteen years of its operation lost the state banks of Oklahoma $3,647,486.42. Warrants outstanding at time of repeal were $1,336,000. These warrants had been issued for the purpose of paying depositors in failed banks and were mostly

held by the banks themselves. No provision was made in the repealing act for the payment of these warrants.

The bank commissioner said, "In addition to the banking board warrants there was due to depositors in banks that had failed from the time the law became insolvent and inactive down to the date of its repeal, about $6,000,000. This amount has since been reduced by means of liquidation, but there still remains a large deficit in the fund, and it is not likely that any of the banking board warrants or any of the amount due to depositors under the provisions of that law will ever be paid."[1]

4. Causes of the Failure of the Guaranty Law in Oklahoma. Among some of the causes of failure in the Oklahoma experiment in deposit guaranty may be mentioned, poor financial condition of many banks when the law went into operation, lack of adequate examination and supervision, and economic conditions in Oklahoma during the fifteen years of the operation of the law.

When it is recalled that the guaranty law was passed in December, 1907 and was to go into effect on the 14th of the February following, we realize what a tremendous task the state bank commissioner must have had to examine the 467 state banks in Oklahoma at the time of the inauguration of the law. Those well acquainted with the banking business know that, to be a good bank examiner one must have had considerable banking experience and understand the technicalities of

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[1] Letter from State Bank Commissioner of Oklahoma to the writer, October 7, 1927.

bank examination. There were few that could qualify for this work, but something had to be done immediately, so the governor appointed by telephone thirty-one bankers of the state as special examiners.[1] Since the state had no machinery to carry out these examinations the special examiners had nothing to guide them. As a result many insolvent banks were admitted to the protection of the guaranty fund.

Another influence that made the situation worse was the political domination of the banking board. This caused the board to admit a bank into the system regardless of its shaky financial condition. Of course, if a bank was insolvent, it could not be admitted, but many were admitted that were a source of grief to the fund later.

There was no provision in the law to prohibit the indiscriminate granting of banking charters. As a result many banks were organized where banks were already too numerous. This was especially true of small towns and villages where the minimum capital requirement was only $10,000. The banking board, being purely political, did not take special pains to investigate the character and reputation of the incorporators, and as a result swindlers and crooks were too often granted banking charters.

Thornton Cooke,[2] in 1913, made the following statement in regard to the Oklahoma guaranty law:

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1 First Annual Report of the Bank Commissioner, 1908.

2 Cooke, Thornton, Quarterly Journal of Economics, 1913, 28:69.

"The plan has failed, because the loss experienced has far outrun the theoretical ratio. The reason of the heavy losses, as they have been narrated in the foregoing discussion, may be here summarily stated: (1) The banking department was for a long time in politics. (2) Unsound banks were admitted and guaranteed at the outset. (3) The record of bankers has not been properly traced. (4) There has been procrastination in closing insolvent banks and timidity in the face of losses. (5) Economic conditions have been somewhat adverse. (6) The guaranty of deposits has relieved depositors of all necessity for care in selecting banks.

"The first four of these are not arguments against deposit guaranty, because they arise from conditions that can be corrected. Politics can be measurably eliminated from the administration of the state banking department. The record of men who wish to organize banks can be found out. Reasonably efficient bank examination can be had, and weak banks can be closed without the wasteful temporizing that we have seen in Oklahoma. Can any guaranty plan, however, withstand seasons of bad crops, and can any plan otherwise adequate, maintain the interest of the depositor in the soundness of the bank? It is by these tests that the guaranty principle must stand or fall."

Mr. O. B. Mothersead, the present bank commissioner of Oklahom, a careful student of the guaranty law, and having been in charge of the banking department during the closing years of the guaranty law experiment, has this to say about it:

"The depositors' guaranty law, through the manner in which it was administered almost wrecked the state banking banking system in Oklahoma. During its life solvent banks paid into the fund about $3,700,000 in the form of assessments. In addition to the assessments they lost the securities they had placed with the banking board for the purpose of guaranteeing the payment of assessments and the payment of banking board warrants outstanding. The law specifically provided that each bank should keep on deposit with the banking board, securities equal to one per cent of their total average daily deposits. These securities were deposited for the purpose of guaranteeing the payment of the assessment and the payment of banking board warrants issued by the banking board. There was a little more than $9,000,000 in banking board warrants issued during this time and the amount of salvage recovered from collections during that period was rather small, owing to the fact that the bank commissioner did not have sufficient help to prosecute collections diligently, as should have been done.

"It is my judgment that any law which seeks to guarantee deposits in banks is fundamentally unsound, as it places a premium on incompetence, if not actual crookedness and opens up a field which presents temptations to the unscrupulous politician. In this state it resulted in the granting of charters promiscuously and in many instances charters were granted to inexperienced and incompetent parties.

"I do not believe that any guaranty law will withstand the demands made upon it over a period of years and I confidently expect to see the states which now have a depositors' guaranty law in effect suffer the same loss and humiliation that the state banking system in Oklahoma underwent. Since the repeal of the law, the banks in Oklahoma have regained the confidence of the people and now have an opportunity to function as banks should function."[1]

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1 Letter from the Bank Commissioner of Oklahoma to the writer, October 7, 1927.

Chapter VI

The Operation of the Guaranty Law in Kansas

1. Voluntary Participation. Only two of the eight states in the union that have enacted guaranty laws, made participation in the guaranty fund optional. The two states were Kansas and Washington. In Kansas, only those banks that have been in successful operation for at least one year, and have an unimpaired surplus of at least ten per cent of the capital stock, are permitted to qualify for participation in the guaranty fund. The purpose of these requirements is to prevent unsound banks from coming into the system. Kansas was more fortunate than Oklahoma in this respect, for as already indicated in Chapter V, Oklahoma admitted a number of unsound banks at the very beginning of the guaranty experiment. Another good feature of voluntary participation is that the bank commissioner is given more time in which to examine the banks, no definite time of admittance being required as was the case in Oklahoma.

Any bank is permitted to withdraw from the guaranty fund with the approval of the bank commissioner, provided it has paid its share of the losses to the depositors of all failed banks belonging to the system. A withdrawing bank is also held liable for any losses by member banks within six months after the date of application to withdraw. At the expiration of six months after date of application the bank commissioner returns the bonds or cash which the withdrawing bank has deposited as security for the payment of assessments

The bonds, or cash in lieu of bonds, which the banks are required to put up as security equals to $500 for every $100,000 of average daily deposits, less capital and surplus.[1] In a recent decision of the Supreme Court of Kansas, April 10, 1926, the court held that any bank desiring to withdraw from the guaranty system, may do so by forfeiting its security bonds, and thus relieve itself of all further liability.[2] More will be said of this court ruling later on in this chapter.

The law was passed in March and went into operation June 30, 1909. Deposit guaranty was very popular at that time, and immediately many banks filed application and paid the assessments required so as to avail themselves of the privileges of the new law. On September 30, 1909, after three months of operation, three hundred banks had enrolled in the guaranty system and were protected by the fund.[3] There were over one hundred fifty additional applications on the above date pending action of the bank commissioner. The number of state banks in the system and those outside, are shown in the table on the following page. The table shows that the growth of the system was steady until 1922 when the number of banks in the guaranty system began to decrease. From 1912 to 1922 a little more than one half of the state banks were guaranty members, and during this time assessments were extremely light, due to few bank failures.

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1 Bank Depositors' Guaranty Law, Section 2.
2 Commercial and Financial Chronicle, 1926, 122:2599-600.
3 Cooke, Thornton, Quarterly Journal of Economics, 1909, 24:354.

Number of State Banks in Kansas, 1912 to 1927[1]

Year	Number of Banks		
	Under Guaranty System	Not Under Guaranty System	Total
1912	457	445	902
1913	472	446	918
1914	499	440	939
1916	539	348	987
1918	604	440	1044
1919	649	443	1092
1920	676	437	1113
1922	703	391	1094
1923	691	381	1072
1925	645	---	----
1927	93	874	967

The fact that only a few more than half of the state banks joined the system during a period of prosperity, and therefore light assessments, is an indication that the bankers of the state were not especially enthusiastic over the guaranty idea. It must be remembered in this connection, however, that a number of smaller state banks did not have sufficient surplus to admit them to the guaranty fund.

2. Bank Failures. Kansas was more fortunate than Oklahoma in the early years of guaranty operation in that fewer bank failures occurred. During the first ten years of operation only two failures

[1] Compiled from Reports of the Bank Commissioner.

are recorded. The first bank to be closed under the guaranty system was the Abilene State Bank, Abilene, Kansas, which was closed in September, 1910. The failure of this bank was in no way due to the guaranty law, but to the crookedness of its cashier, who was later sent to the penitentiary for embezzlement of the bank's funds.

The bank commissioner immediately took charge, and as soon as claims were established, issued interest-bearing certificates as provided by law. By June, 1912, $40,408.48 of these certificates were outstanding. The assets of the bank in the hands of the receiver amounted to $97,526.96,[1] most of which proved to be bad in the process of liquidation. When the affairs of the bank were finally closed in November, 1913, it was necessary to draw on the guaranty fund for $28,701.26.

The second failure under the guaranty system was the Kansas State Bank of Salina, which closed in May, 1919, costing the guaranty fund over $250,000. Like the Abilene bank, this one was closed on account of the embezzlement of the bank's funds by its president and cashier. Felix Broeker and H. J. Lefferdink, the latter the bank's cashier, had purchased a ranch in New Mexico for $440,000.[2] These officials had sold some time certificates belonging to depositors amounting to $25,000 with which to make the initial payment on the ranch. Lefferdink gave his personal note to the bank for $125,000 with which to make the second payment. The total owed to the bank

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1 Eleventh Biennial Report of the Bank Commissioner.
2 Kansas City Star, October 24, 1919.

by its officers and those closely assiciated with it was $448,000, the amount being charged against Lefferdink was $224,105.

The worst bank failure in the history of the guaranty fund in Kansas was the American State Bank of Wichita. It closed its doors on June 18, 1923, after much speculative activity had been carried on by the bank officials. The bond account was $1,500,000 short. Bonds that had been left with the bank for safekeeping were exhibited to the bank examiners as property of the bank. Certain loans had been made to oil interests contrary to law. The total loss was about $2,000,000. The deposits at the time of closing amounted to $4,600,000, less offsets of capital, surplus, and undivided profits, all amounting to $400,000.

J. N. Richardson, the president, was tried in the courts and found guilty of violating the state banking laws. He was convicted on nine separate counts, and sentenced five years in the state prison on each count. The judge held that the nine five-year terms should run consecutively, so he was given a term of forty-five years. Richardson began serving his term in prison in October, 1926.[1] According to the Kansas City Star of July 25, 1928, Mr. Richardson was pardoned on that date by Governor Paulen. It will be noted that he served only one year and nine months of his forty-five year sentence. Such gross laxity on the part of our state officials, in enforcing the law against crooked bank officials and embezzlers of the depositors' money, has had a great influence toward the downfall

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[1] Kansas City Star, July 25, 1928.

of deposit guaranty, ispecially in Oklahoma and Kansas. Nebraska has had better success in this respect by adopting a rigid program in the punishment of violators of the banking law.

It must not be understood that all bank failures under the guaranty system were results of the actions of unscrupulous bank officials, for such was not the case. Many failures occurred during 1923 and 1924 under the supervision of honest and capable men. In 1923 the wheat crop in Kansas was poor and the corn yield that year was very much below normal. These crop failures resulted in many financial difficulties over the state.

The years immediately following the depression of 1920-21 were severe ones for the Kansas guaranty fund. Twenty-five banks under the guaranty system failed between January 1, 1919 and January 1, 1923.[1] Thornton Cooke, writing in November, 1923, said, "Kansas had a disappointing wheat yield this year, and corn was a failure in the southern part of the state. Many banks that had been holding on through the agricultural depression of the past three years have finally succumbed.

"Twenty-three state banks (four in one week) have been closed so far this year, and four reopened. The commissioner has adopted a policy of closing banks as soon as it appears that their case is hopeless. He believes that better reorganizations--more thorough house-cleanings--can be had after they are closed than while they are open and running without public confidence. No doubt he is right.

"The Guaranty Fund has $860,000 cash on hand, and holds about

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[1] Cooke, Thornton, Quarterly Journal of Economics, 1923, 38:122.

$1,140,000 of bonds to secure the payment of future assessments. There are $5,500,000 of guaranty certificates outstanding, two thirds of which the bank commissioner expects to be paid out of the assets of failed banks themselves."[1]

The following table gives the date and number of bank failures under the guaranty system from date of its inauguration, June 30, 1909, to May, 1925 at which time it was bankrupt.

Bank Failures Under the Guaranty System[2]

Date	Number of Failures
September, 1910	1
May, 1919	1
May, 1920	1
September 1, 1921 to September 1, 1922	16
January 1, to November 1, 1923	23
November, 1923 to May, 1925	25

Let us turn attention to the condition of the guaranty fund in November, 1923. As stated above there was $5,500,000 of guaranty fund certificates outstanding. As provided by law, the certificates issued for non-interest bearing deposits bear six per cent interest from date of bank failure until paid. Certificates issued on interest bearing deposits bear the same rate of interest as did the deposits.[3] The average rate of interest on the outstanding certificates

1 Cooke, Thornton, Quarterly Journal of Economics, 1923, 38:123.
2 Compiled from the Reports of Bank Commissioner.
3 Bank Depositors' Guaranty Law, Section 3.

would be about five per cent. If to the certificates outstanding we add the loss from the American State Bank of Wichita, (which was not included in Cooke's report above) and figure the interest at five per cent, we have an annual interest charge of $500,000. The regular assessment, allowed only when the fund is below $500,000, plus the four special assessments of one twentieth of one per cent would net about $450,000 annually. This is about $50,000 less than the interest charge on the outstanding certificates.

The condition in November, 1923, as described above, probably could have been relieved through the liquidation of the assets of the failed banks had no more failures occurred for a few years. But between November, 1923 and May, 1925, twenty-two more guaranty fund banks were closed, putting the fund in a hopeless condition.

The State Supreme Court of Kansas handed down an opinion on April 10, 1926, which virtually killed the Kansas Depositors' Guaranty law. The court ruled that any member of the guaranty system may withdraw at any time by forfeiting its security bonds. In other words, the ruling was of the effect that no bank can be assessed beyond the amount of the bonds which it has deposited with the state as security for the payment of assessments. The result of this ruling of the Supreme Court was a wholesale exit from the guaranty system by the member banks. June 11, 1927, only 97 banks were left under the operation of the fund.[1] On April 1, of this year, (1928) there were 40 banks still in the system. The fund owed to the de-

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[1] Commercial and Financial Chronicle, 1927, 134:3440.

positors on June 11, 1927, $6,000,000, the total assets of the fund including security bonds that have been forfeited amount to $1,000,000. Thus the depositors must lose $5,000,000.[1]

The litigation to determine the method of liquidation of the guaranty fund and how the depositors were to be paid has been in the courts three years. With the large amount of claims and the small amount of money and bonds in the guaranty fund, the court appointed Mr. S. C. Bloss of Winfield as a special commissioner to determine the order in which the banks were to be paid. The special commissioner gave his opinion to the Banking Department at Topeka, April 6, 1928, in which he said, "Twenty-six banks have been fully liquidated and there is only enough money in the guaranty fund to pay nine of these banks in full, the balance will be pro rated to the tenth and eleventh banks."[2] As indicated in the above quotation the depositors of failed banks were to be paid in full in the order of failure. The reason the balance was pro rated with the tenth and eleventh banks was that they failed on the same day. The depositors of the remaining fifteen banks that had been fully liquidated under the guaranty law before it became inactive, had to bear the five million loss.

3. The Effects of the Guaranty Law on State and National Banks. The immediate effect of the guaranty law in Kansas was to increase the number of state banks. During the first ten years of guaranty operation state banks increased in number from 747 in 1908 to 1064

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1 Commercial and Financial Chronicle, 1927, 134:3440.
2 Kansas City Star, April 11, 1928.

in 1918, an increase of forty-one per cent. During the same period national banks in Kansas increased in number from 211, in 1908 to 236 in 1918, an increase of only eleven per cent. Deposits in state banks in the ten year period increased from 76.7 million dollars in 1908 to 249.7 million dollars in 1918. This was an increase in deposits in state banks of 225 per cent. The per cent of increase of deposits in national banks during the same time was only eleven and one half per cent. In tabulated form the above results are as follows:

	Number of Banks		Deposits[1]		Per cent of Increase	
	1908	1918	1908	1918	In No. of Banks	Deposits
State Banks	747	1054	76.7	249.7	41	225
National Banks	211	236	67.7	137.7	11	11.5

The extremely large increase in deposits in state banks during the first ten years of guaranty operation was due to the wave of popularity of the guaranty of bank deposits. Another cause for the increase may be attributed to the unusually large number of new banks organized soon after the guaranty law went into operation. Mr. F. S. Wettack said that the spirit of the Kansas guaranty was, "Get a charter, get guaranteed, pledge bands and effectively compete for deposits on equal basis with long established, successfully managed banks."[2]

Before the collapse of the guaranty system there was one bank in Kansas for every 1,140 people; in the New England States there is one

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1 Figures representing money are in million dollars.

2 Bankers Magazine, May, 1926, Vol. 113.

bank for every 7,300 people.

4. Conclusion. I shall attempt to outline some of the causes of the collapse of the Kansas Guaranty System as given by some of the prominent bankers of the country.

Roy L. Bone, present bank commissioner of Kansas says, "The guaranty law is fundamentally unsound in principle."[1]

F. S. Wettack says, "The reserve was too small....The plan assumed that anyone could run a bank, farmer, lawyer, doctor. No provision was made to prevent losses, its object being to repair losses."[2]

Mr. W. M. Peck[3] as president of the Kansas Bankers' Association in 1909, predicted the downfall of the system. He also indicated that the reserve of $500,000 was far too small.

The argument of inefficient administration and supervision is probably the most commonly offered, and the writer belives it to be the most fundamental. State governments, as a rule, do not have adequate machinery for the strict enforcement of the banking laws. Politics under our present state organization, hinders rigid bank inspection and punishment of law violators.

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1 Roy L. Bone in conversation with the writer, October, 1927.
2 Bankers' Magazine, May, 1926, Vol. 113.
3 Ibid.

Chapter VII

The Operation of the Guaranty Law in Nebraska

1. Special Features of the Nebraska Law. In recent correspondence with the banking authorities of Nebraska, the writer has been informed that during the seventeen years of the operation of the guaranty fund no depositor in a state bank has lost one cent through the failure of a bank. Nebraska stands alone in this respect. The financial depression of 1920 to 1925 wielded a severe blow to guaranty laws. Because of the bankruptcy of the guaranty fund three states have repealed their laws guaranteeing deposits; Oklahoma in 1923, South Dakota in 1925, and Texas in 1927. The Kansas law became inactive in 1926 as a result of the Supreme Court ruling that assessments could not be made in excess of bonds deposited with the state as security for the payment of assessments. In Mississippi, Washington, and North Dakota the guaranty fund is hopelessly in debt. The deflated conditions of the past seven years have been a severe shock to the Nebraska guaranty fund, but it appears at this time to be recovering.

In 1922, Nebraska bankers, benefiting by their own experience as well as that of other states, could easily foresee that unless the causes which proved to be the undoing of the law in other states were removed from Nebraska's law, it too, would result in bankruptcy. In part, the bankers have been successful in removing some of the objectionable features of the law and placing it more nearly on a business-like basis through the creation of a guaranty fund commission.

As a result of the demand from the bankers for a voice in the management of failed banks and the salvage of the assets, the legislature of 1923 passed the Guaranty Fund Commission law, creating a commission of seven members and the Secretary of the Department of Trade and Commerce, who is chairman and a member ex officio.

The state is divided into seven districts and one member of the commission is appointed from each district. To be eligible for membership on the commission one must have been an executive officer of a bank in Nebraska for at least five years preceding his appointment. The bankers of each district select the member of the commission to represent them.

The law provides that the commission shall have full charge of failed banks, and that it shall have no jurisdiction over going banks except in an advisory capacity.[1] Solvent banks are under the jurisdiction of the Department of Trade and Commerce, but upon the closing of any bank it must be turned over to the guaranty fund commission for the purpose of restoring solvency or liquidation. The expense of the organization is borne by the banks, except for an appropriation of $15,000 per year made by the legislature.

To enable the commission to operate a bank the law of 1923 provided for the creation of a fund known as the Bankers Conservation Fund, for which an assessment is made on all state banks. The

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[1] Pamphlet sent to the writer by Van E. Peterson, Secretary of the Guarantee Fund Commission.

assessment for the conservation fund in any year is not to exceed one fourth of one per cent of average daily deposits.[1] The conservation fund is entirely separate from the guaranty fund. It really amounts to a loan by the bank to the commission, and in case there there should come a time when there are no insolvent banks under the supervision of the commission, the balance in the conservation fund would be returned to the banks in proportion to the contributions.

Another distinctive feature of the Nebraska law is the method of paying depositors of failed banks. Depositors are paid immediately after the closing of the bank. From the time the law went into operation in 1911, until April, 1923, depositors of failed banks were paid immediately out of the guaranty fund. In 1923, when it was evident that the fund could not meet the demands of the depositors, an amendment was passed by the legislature providing for the issuance and sale of receivers' certificates.[2] Since 1923 depositors have been paid in cash received from the sale of receivers' certificates to investors. The state banks buy most of the receivers' certificates.

The banking authorities of Nebraska claim as one of their reasons for having withstood the shock of the past few years, that the guarantee fund commission has netted them great savings through the efficient operation of insolvent banks. When a bank is closed by the

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1 Federal Reserve Bulletin, September, 1925, p. 634.

2 Secretay's Report to the Guarantee Fund Commission, June 30, 1927.

Department of Trade and Commerce it is turned over to the guarantee fund commission, which has the option of either continuing the bank as a going concern without regard to its solvency or liquidating its affairs through a receiver to be named and appointed by the commission. The claim that great savings are made from the efficient operation of insolvent banks is justified when we compare the results of liquidation under the old receiverships previous to 1923 with the results of liquidation under the commission since 1923. Under the old receiverships the realization on assets was 43.54 per cent of book value, while the realization on assets under the commission from 1923 to 1927 was 66.12 per cent of book value.[1]

2. Bank Failures and the Guaranty Fund. In Nebraska, as in other states, losses from bank failures have been very heavy in recent years. During the guaranty period to the end of 1924 assessments (less refunds) and amount paid to depositors in failed banks have been in the following amounts:[2]

	Assessments	Paid to Depositors
1911 to 1919.....	$2,367,280	$239,390
1920 to 1924.....	7,694,042	8,730,645

Assessments in the year 1921 exceeded the total assessments during the nine years 1911-1919, and payments to depositors in that year totaled $2,721,719.[3]

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1 Secretary's Report to the Guarantee Fund Commission, 1927.
2 Federal Reserve Bulletin, September, 1925, p. 634.
3 Ibid.

It will be remembered that as provided in the Nebraska guaranty law, the guaranty fund is kept by the banks themselves. When an assessment is made each bank is notified of its share and the amount is credited to the guaranty fund on the books of the bank. The commission draws on the bank to pay the depositors of failed banks. In May, 1925, deposits to the account of the guaranty fund in the 922 participating banks totaled $2,689,340, and guaranteed deposits in these banks exceeded $250,000,000. Receivers' certificates outstanding on the above date totaled $1,705,699, but the fund was sufficient to pay these and have a balance in the fund of about $1,000,000.

To give a summary of the condition of the fund in 1926, a quotation is taken from a member of the guarantee fund commission:[1]

"For more than 15 years of operation since 1911, 155 banks have been closed by the state. Practically all of these have been closed during the past five years. Of this number 114 have been placed in receivership and deposits of over $28,000,000 paid in full. The commission is now operating 37 banks as going concerns. Of the $28,000,000 paid to depositors, the state banks have contributed about $11,500,000, the balance being secured from the assets of failed banks. During the past twelve months the commission has paid more than $7,500,000 of deposits or an average of $25,000 per day.

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1 Van E. Peterson, Secretary of the Guarantee Fund Commission in a pamphlet sent to the writer.

There remains in the hands of the commission more than $10,000,000 of assets belonging to the banks whose deposits have been paid in full."

During the fiscal year ending June 30, 1927, forty banks were closed by the Department of Trade and Commerce and turned over to the guarantee fund commission. Three of these banks were immediately put into the hands of receivers for liquidation and thirty-seven are being operated as going concerns. The total assets of the forty banks that were closed during the year amounted to $11,759,-685.25, and the liabilities totaled $10,643,566.04.[1]

A summary of the number of bank failures in Nebraska from the beginning of the operation of the guaranty law, January 3, 1911 to June 30, 1927 is given below:

Number of Bank Failures in Nebraska
1911 to 1927

Date	Number of State Bank Failures
1911 to 1920.....	3
June 30, 1920 to June 30, 1923.....	57
June 30, 1923 to June 30, 1926.....	91
June 30, 1926 to June 30, 1927.....	40
Total.....	191

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[1] Report of the Guarantee Fund Commission, June 30, 1927.

Perhaps the reader is wondering how a guaranty fund can withstand such a large number of failures without being hopelessly in debt. Of course the Nebraska fund was seriously embarrassed but may be able to recover due to two unusual conditions. Since 1923 the banking department has carried out a policy of closing banks as soon as they are found to be in an unhealthy condition. The department does not wait until the bank is unable to pay its depositors and voluntarily closes its doors, as has been the case in Oklahoma and Kansas, but the banks are closed by the banking department before they are in such hopeless condition. The policy of early closing of the banks has resulted in a large number being handled through the commission . Possibly some that were closed could have pulled through without assistance. Another result of the policy of close supervision is that the guaranty fund commission always has a large volume of assets of closed banks on hand for liquidation. During the fiscal year ending June 30, 1927 the liquidation of assets of closed banks was $5,003,642.38.[1] A statement of the receivers' certificates for the fiscal year ending June 30, 1927, is given on page 89.

3. A Movement for State Aid. An article which appeared in a leading newspaper of Nebraska in August, 1927, a part of which is reprinted here for the purpose of showing the distressed condition of the guaranty fund at that time.

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[1] Report of the Guarantee Fund Commission, June 30, 1927.

Statement[1] of Receivers' Certificates
for Fiscal Year Ending June 30,
1927

Certificates outstanding July 1, 1926		$2,241,961.00
Certificates issued and sold		1,718,702.19
Total		$3,960,663.19
Certificates paid by cash:		
Received from assets	$ 114,696.27	
Received from Guaranty Fund	2,505,403.24	$2,260,099.51
Certificates outstanding June 30, 1927		1,340,563.68
Total		$3,960,663.19

"The suggested plan to have the state of Nebraska give some assistance to the guaranty fund in paying off all depositors in failed banks is deserving of careful attention. Heretofore the burden of such payments has been borne entirely by the state bankers, who have contributed over $14,000,000 in regular and special assessments to make good the deposit liabilities of suspended banks to the public. It would seem that the state might well render some assistance in effecting a general cleanup of the remaining obligations.

"Originally enacted solely for the protection of the depositors, the guaranty law of Nebraska has been a great benefit during recent years of financial depression enabling the state to come through its period of adversity in better shape than some of its neighbors.

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[1] Report of the Guarantee Fund Commission, June 30, 1927.

It has the effect of preserving confidence in going banks and preventing "runs" such as used to be experienced. Business conditions have thus been stabilized to a degree which would probably not have been possible except for the operation of the guaranty fund.

"Through all these trying times the state bankers have stood loyally behind the law, paying heavy assessments year after year to meet the losses of suspended institutions. In a great many cases this was done at the expense of profits and dividends to stockholders.

"A movement is now under way among the state bankers to wipe the state clean by issuing and selling receivers' certificates in a sufficient amount to pay off all claims against suspended and insolvent banks still remaining in the hands of the guaranty fund commission. If that were done, it would greatly strengthen Nebraska's position in the financial and business world and enable the state to go forward more rapidly in the future.

"To accomplish such a laudable object, it does not appear unreasonable that the state itself should go "fifty-fifty" with the bankers. The proposal that the next legislature appropriate a sum of money to be used in that way and provide for raising it by a special tax levy, if necessary, is not in the nature of a bonus or subsidy to banks. Every cent of the money would go to pay the depositors, and the solvent banks would contribute as much as the state.

"In Iowa, which has no guaranty law, the last legislature appropriated several million dollars to help meet the claims of depos-

itors in banks that were closed during the past two or three years. Other states have taken similar action. In Nebraska, where the going banks have been carrying all the load heretofore, it seems equitable that the state government should do something to assist them in making a final cleanup."[1]

4. Effects of the Guaranty Law on State and National Banks in Nebraska. For fifteen years prior to the enactment of the guaranty law, March 25, 1909, there was scarcely any losses from bank failures. Because of this excellent banking record many bankers were opposed to any form of deposit guaranty. The public was also somewhat indifferent which encouraged bankers in their opposition. A group of bankers in the northern part of the state secured an injunction preventing the law from going into effect for over two years after its enactment. The Supreme Court of the United States finally handed down an opinion decreeing that the law was constitutional and it went into effective operation January 3, 1911. Because of opposition to the guaranty law and wishing to avoid the assessments thirty-one banks left the state system and took out national charters during the first four years following the enactment of the guaranty law: seven in 1909, five in 1910, eight in 1911 having a capital of $390,000, and eleven in 1912 having a capital of $420,000.[2]

There was a decided growth in state banking in the four years mentioned above, not taking into consideration the thirty-one banks

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1 The Lincoln Star, August 19, 1927.

2 Report of the Secretary of the State Banking Board, 1911.

that joined the national system. November 16, 1909 there were 662 state banks in Nebraska with deposits amounting to $71,000,000, and November 26, 1912 there were 694 banks with deposits amounting to $80,631,000.[1]

The number of national banks in Nebraska in 1909 was 219, while in 1912 the number had increased to 245. This was a greater increase in number than the state banks made during the same period, but the growth in deposits was greater in state banks. The increase in deposits of national banks was 10 per cent, while in state banks the increase was 12 per cent.

The period from 1912 to 1919 was a happy one for state banks of Nebraska, because of a prosperous period and scarcely no losses from bank failures. The number of banks increased 37 per cent and deposits increased 306 per cent during the eight years. In 1912 there were 246 national banks and in 1918 the number had decreased to 191. This shows a decrease in the number of national banks of 22 per cent, but during the period the deposits in national increased from $90,400,000 to $148,200,000,[2] an increase of 64 per cent in deposits.

It was during the years from 1912 to 1920 that the guaranty law of Nebraska won the confidence of the state banks and the majority of them are still boosters for the law. There appears to be a growing sentiment among bankers of Nebraska that the administration of the banking laws should be removed from political control.

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1 Report of the Secretay of the State Banking Board, 1911.
2 Report of the Comptroller of the Currency, 1918.

No doubt this would be a wise move for Nebraska. Many other states would do well to seriously consider the removal of banking administration from political influences.

Chapter VIII

The Operation of the Guaranty Law in Other States

1. Similarity of State Laws. In many respects the guaranty laws of the various states are very similar. This is expecially true in regard to the character of the guaranty provided in the laws, the basis of assessments, and the larger aspects of administrative control.

The guaranty has in all cases been undertaken by the banks and not by the state as many persons were led to believe in the early days of the movement. When the law was new and not very well understood by depositors, many advertisements by bankers left the impression that deposits were guaranteed by the state. Consequently the states have required, either in the original law or in an amendment, that banks make it clear in all advertisements that the state is not guaranteeing deposits. A penalty of fine or imprisonment is provided in the law.

In all of the states having a guaranty law state banks are assessed a limited amount based on the average daily deposits of the preceding year. The money from the assessment is turned over to a state official or credited on the books of the bank to the banking department of the state.

A maximum rate which may be levied upon solvent banks in any one year is commonly designated. A maximum amount for the fund, with a provision that assessments shall cease when the fund has

accumulated to this maximum, is usually provided.

2. Texas. The guaranty law of Texas was passed August 9, 1909, went into effect January 1, 1910, and Governor Moody signed a bill February 11, 1927 repealing the law in its entirety. During the seventeen years experience the state had its share of difficulties, not all caused by the guaranty law, however.

It was not until 1904 that Texas passed her general banking law permitting state banks. Before that time all banks in Texas were operating under the national banking act. The state had been administering the banking laws only five years when the guaranty fund system went into effect. The minimum capital stock required of a bank was only $10,000. This was found to be far too low and many bank failures occurred during the five years between the inauguration of the general banking laws in 1905 and the passage of the guaranty law in 1909. One bank failed in 1906, twenty months after its organization, eleven closed in 1907, and twenty more failed in 1908. These failures aroused considerable public sentiment, and it was generally felt that something must be done to prevent so much suffering from bank failures. As deposit guaranty was the most popular banking reform of that time, the major political parties having approved it in their platforms of 1908, Texas adopted the law the following year, and added more difficulties to its already inadequate banking statutes.

The first failure under the Texas system occurred August 7,

1911, when the Harris County Bank and Trust Company of Houston was closed. The chief cause of failure was dishonest methods of bank officials. The protected deposits amounted to $190,000. The final net loss to the guaranty fund was $39,065.36.[1]

The assessments of solvent banks and payments to depositors of banks which have failed during the active operation of the guaranty law are given as follows:[2]

Payments made to Depositors of Failed Banks
1910 to 1925

September 1, 1910 to September 1, 1920	$ 881,500
Year ended September 1,	
1921	3,998,441
1922	4,227,587
1923	1,917,708
1924	1,743.420
September 1, 1924 to April 29, 1925	4,329,351

During the ten year period ending September 1, 1920, a total of $571,000 was realized from the sale of assets of failed banks, and in the period from September 1, 1920 to December 15, 1924, a total of $2,717,845 was realized. Cash on hand in the guaranty fund May 1, 1925, amounted to $968,556, and there was $3,085,889 on deposit in banks subject to check by the state banking board.[3] The liability

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1 Robb, Thomas F., Guaranty of Bank Deposits.
2 Federal Reserve Bulletin, September, 1925, p. 633.
3 Ibid.

of the fund to depositors on account of failed banks was $181,052, on May 1, 1925. There were no unpaid warrants or certificates outstanding.

W. A. Philpott, Jr., Secretary of the Texas Bankers' Association says, "Everything ran merrily in Texas during the first ten years of operation of the depositors' guaranty law. There were almost a thousand banks under the system, no depositor had lost a dollar in a guaranty fund bank. Twenty banks failed in the ten years, member banks paying depositors about $1,000,000, which was considered a good record.

"In 1920 the depression came and in six years ending January 1, 1926, there were 150 failures of guaranty fund banks, 52 of which were reorganized without loss. Solvent banks paid $17,000,000 to depositors of failed banks during that time."[1]

In 1925 a law was passed which provided that a bank could be relieved of guaranty fund liability by furnishing a bond the size of its capital stock, a personal or security bond. The immediate effect of this law was a rush to get out of the guaranty system. Of the 850 banks in the system when the law was passed, only 24 remained when the law was repealed February 11, 1927. These 24 were too weak financially to furnish the bond required of the law of 1925, or they would have left the guaranty system.

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1 1 American Bankers Association Journal, March, 1927, p. 659.

The number of state and national banks and deposits in each at various times during the guaranty period are shown in the following table:[1]

Number of State and National Banks and Deposits in Each Class from 1910 to 1924

Year	Number of Banks		Deposits (in thousands of dollars)	
	State	National	State	National
1910	533	519	27,573	145,249
1914	789	519	52,219	174,033
1920	908	561	211,460	524,544
1921	937	553	163,694	365,372
1922	905	559	156,793	495,388
1923	881	569	156,409	532,309
1924	867	576	176,393	594,402

It will be seen that the number of state banks increased much more rapidly than the national banks from 1910 to 1920. After 1921 there was a decrease in the number of state banks, but an increase in the number of national banks. This is accounted for in part by the popularity of bank organizations sonn after the guaranty law went into effect. The minimum capital required for erganizing a bank was only $10,000, and almost any three persons could raise this amount and start a bank. From 1910 to 1920 the deposits in state banks increased

[1] Federal Reserve Bulletin, September, 1925, p. 6333.

681 per cent, while the deposits in national banks during the same period increased only 261 per cent. From 1920 deposits in state banks decreased until 1924 when there was a slight increase.

W. A. Philpott, Jr., referred to page 97, gives as reasons for the failure of the guaranty fund in Texas the following:

1 "The plan makes for too many banks and too few bankers. The incompetent, the inefficient, the reckless, and the venturesome are attracted.

2 "The system does not increase deposits or build a bank.

3 "The plan hinders the prosecution of bank wreckers.

4 "It weakened the financial structure of the state."[1]

3. Mississippi. It was pointed out in chapter IV that Mississippi has an unusual banking law in that the bank examiners are elected by popular vote. Another unique feature of the Mississippi guaranty system is that it was a part of the original banking laws of the state. Previous to 1914 when the guaranty law was passed Mississippi had no laws providing for bank regulation and supervision. The banks were given charters and allowed to operate as they pleased. The general banking law became effective immediately after passage, but the guaranty feature did not become effective until a year later. This gave the examiners time to weed out the worst banks, but later it was found that many had been admitted that should not have been.

The experiences of the guaranty law in Mississippi were pleasant for the first five years, but as in other guaranty states, trouble

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[1] American Bankers Association Journal, March, 1927, p. 659.

began with the deflated conditions of 1920. Twenty-one state banks failed between 1915 and 1923, fourteen of the failures coming in 1921 and 1922. From the establishment of the system to the end of 1922, banks paid $884,000 into the fund, and about one half of this amount was paid in 1921 and 1922. On May 1, 1922 the fund had outstanding liabilities to depositors of failed banks amounting to $1,035,000, cash and other assets of the fund totaled $243,000, leaving a deficit of $792,000.[1] The maximum assessment in 1923 returned $210,000. If no more failures had occurred after May 1, 1923 the fund could have been out of debt by 1928.

In June, 1925, guaranty certificates outstanding totaled $1,540,-766. Assessments during the ten years, 1915 to 1925, totaled $1,395,-697, and amounts paid to depositors in failed banks during that period totaled $1,766,769. About $423,484 had been realized from assets of failed banks. From the above figures it is estimated that about six or seven years will be required to pay off the outstanding certificates of June, 1925.

4. South Dakota. The legislature of South Dakota in 1925 repealed the depositors' guaranty law, to become effective January 1, 1926. A petition was filed asking that the repeal act be submitted to a referendum vote at the next general election in November, 1926. Because so many depositors of failed banks in South Dakota feared that they would be unable to collect their claims if the law was re-

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[1] Cooke, Thornton, Quarterly J. of Economics, 1923, 38:129

pealed, the vote at the November election resulted in the retention of the guaranty law. The indebtedness of the fund at this time was approximately $40,000,000, and depositors of only a few of the failed banks could expect to receive settlement from the bankrupt fund if the repeal went into effect, so they voted to retain the law hoping that the state would give some assistance in the form of an appropriation or tax levy.

From 1916 to 1922 state banks of South Dakota increased from 498 to 562,[1] thirteen banks being the average in suspension during that time. From 1922 to 1924 there were one hundred twenty-six new failures, and from 1924 to 1926, ninety-three more banks were closed. About one half of the state banks were insolvent at the end of the year, 1926.

The receipts from assessments of banks from February 1, 1916, when the first assessment was made, to January 1, 1926, were $3,167,-473. Of this amount $3,068,200 had been used by January 1, 1926 to pay depositors of closed banks.[2] The amount received back into the fund from the sale of assets of failed banks was $221,547. This left a balance of $320,820 still unused at the close of the year, 1925. If we add to this the assessment income for the year 1926, we have $586,727 and whatever may be realized from liquidation of assets of failed banks. Mr. M. G. Luddy[3] has summarized the condition of the

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1 Sparks, E. S., Dean of the College of Agriculture and Sci., University of S. Dak., Am. Bankers' Association J., Feb., 1927.

2 Ibid.

3 South Dakota Farmer and Breeder, October 1, 1926.

guaranty fund as follows:

Liabilities of the fund in closed banks.....	$41,000,000
Assets in closed banks will probably pay.....	20,500,000
Deficit.....	20,500,000
Interest on deficit at 5 per cent.....	1,025,000
Deposits in state banks...$100,000,000	
Income of one fourth of one per cent, the assessment allowed by law.....	250,000
Deficit on interest alone.....	775,000

5. Washington. It will be recalled that under the laws of two states--Kansas and Washington--participation in the guaranty fund was made optional. During the two years following the enactment of the Washington law, which was signed by the governor March 10, 1917, about 39 per cent of the state banks joined the guaranty system. Forty-six banks and three branches had been admitted to membership by December 31, 1917. In 1918, thirty-nine banks and three branches went into the system, and in 1919, nineteen more qualified and paid membership fees, making a total of one hundred four banks and six branches belonging to the system.

As in most other states the guaranty fund had a happy beginning. The bank examiner, in 1918, said, "The one year and six months of operation of the guaranty fund has demonstrated that the benefits resulting to the banks participating in the syatem are considerable and its success is entirely assured. From a dollars and cents stand-

point it is firmly believed that the increased earnings accruing to the banks as a direct result of the increase of business because of membership in the fund will more than balance any expense connected with it."[1]

According to the bank commissioner's report of November 15, 1920, there were one hundred sixteen banks operating under the guaranty fund system. The total deposits subject to protection was approximately $65,000,000. There were only two large banks in the system, the Scandinavian-American Bank of Seattle, with deposits of $15,824,624, and the Spokane and Eastern Trust Company, Spokane, having deposits of $11,399,486. These two banks had almost one half of the deposits protected by the guaranty fund. The amount credited to the fund on November 15, 1920 was $320,908.[2]

The Scandinavian-American Bank of Seattle was closed July 1, 1921. It being the largest bank under the guaranty system and having deposits of about six times the total annual assessment of all banks, its closing was a death blow to the guaranty law. Practically all banks immediately withdrew from the system, taking advantage of the provision in the law which reads, "Any guaranteed bank may withdraw from the guaranty fund upon giving notice to that effect in writing to the secretary of the guaranty fund board; upon paying all assessments and obligations made against it for the benefit of the guaranty and contingent funds, and upon depositing with the secretary

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1 Robb, Thomas F., Guaranty of Bank Deposits.

2 Preston, Howard H., Univ. of Wash., writing in the Quarterly Journal of Economics, Feb., 1912, 36:350.

of the guaranty fund board, in addition to the amount to the credit of the guaranty fund board in said bank, an amount equal to one half of one per cent of its annual average deposits eligible to guaranty for the preceding year."[1] The total payments turned over to the guaranty fund at the time of withdrawal amounted to about fifteen per cent of the capital stock of the withdrawing banks. The assessments at the time of withdrawal of the banks plus the cash on hand in the guaranty fund and expected realization from assets of Scandinavian-American Bank of Seattle will pay about sixty per cent of the indebtedness to depositors. The balance due depositors will never be paid as there is no source from which to collect it. Besides the loss to depositors, the experiment cost the participating banks of Washington about twenty per cent of their capital stock.

6. North Dakota. Since the North Dakota guaranty law was passed on the same day as the Washington law, March 10, 1917, they had similar experiences the first three years. Up to 1920 one bank had failed costing the fund about $15,000. On March 1, 1920 the fund had $77,843. On September 8, 1923, there were 645 state banks and trust companies with deposits of $64,000,000 under the protection of the fund. The guaranty fund on that date had $525,000 on deposit in the various banks.

The condition of the guaranty fund in 1925 may be briefly explained by a quotation from the Federal Reserve Bulletin:[2]

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1 Guaranty Fund Law of Washington, Section 3308.
2 Federal Reserve Bulletin, September, 1925, p. 635.

"Guaranteed deposits in North Dakota state banks on March 14, 1925, amounted nearly to $86,000,000. In the eight years 1917 to 1924 participating banks had paid assessments totaling $1,274,000. Complete settlements had been effected in the case of two failed banks by the payment of $169,156, and 10 per cent dividend payments to depositors in 58 banks had been made totaling $212,710. The number of participating banks is given as 504; the amount in the fund as $915,505, and the amount of outstanding certificates of indebtedness as approximately $21,000,000. No estimate, it is stated, can be made of the amount of guaranteed deposits in failed banks. Recoveries realized on the assets of closed banks have amounted approximately to $200,000. Assets in the hands of receivers total approximately $35,000 and are estimated to be worth not more than 40 per cent of this value. Under present arrangements a very long period of time would be required to provide out of the assessments for claims admittedly valid against the fund."

Chapter IX

Conclusion

1. Purpose of the Chapter. In the foregoing chapters the nature of bank credit, the growth and development of bank deposits, the guaranty laws of the various states, and the operation of these laws, have all been considered. In the concluding chapter the purpose is to summarize the results of the experiences with the guaranty law, and to attempt to arrive at some conclusions regarding the policy of deposit insurance. The arguments for and against such insurance will be outlined in the light of past experience. These arguments will be limited to what the leading bankers and economists of the country have said about the plan of bank deposit guaranty.

Some phases of the subject most commonly discussed by supporters of the guaranty idea, and which will be considered here, are: the protection of deposits is as essential as the protection of note circulation, the prevention of panics and runs, and the unlimited suffering caused by bank failures. Those opposing the idea contend that deposit guaranty promotes bad banking, that honest and efficient bankers should not be taxed for the deeds of dishonest and incompetent bankers, and that since the bank does not benefit directly from the premium paid it should not be taxed.

2. Experience in Deposit Guaranty. If we measure deposit guaranty by the results of the eight states which have tried it

within the past twenty years we are compelled to admit that it has been a collosal failure. The loss to depositors in Oklahoma during the time the law was in operation, from 1908 to 1923, was over $5,000,000. The solvent banks of that state paid $3,700,000 in the form of assessments during the fifteen years of operation. The losses in Kansas were about the same as in Oklahoma for both banks and depositors, the latter having lost $5,000,000. The banks in Texas were assessed approximately $16,000,000. In Mississippi, Washington, and the Dakotas losses have been proportionate to the losses as given above. Nebraska is the only state in which it is not generally admitted that the guaranty plan has failed. Even the Nebraska bankers are beginning to question the idea. They are now trying to get legislative action providing for an appropriation or general tax levy to help clean up the deficit in the guaranty fund. Without state aid it will take the bankers several years to wipe out the deficit through regular and special assessments. The bankers of Nebraska have already paid approximately $14,000,000 in assessments. Heavy assessments and the efficient operation and supervision of insolvent banks through the guaranty fund commission are two reasons for Nebraska's having pulled through the trying years from 1920 to 1927 better than other states having guaranty laws.

3. The Depositor and the Noteholder. There are those who

claim that depositors have equal rights to protection with noteholders. For many years our laws for both state and national banks have protected the noteholder through the requirement of substantial reserves. Through the past seventy-five years deposits have increased very rapidly and now far exceed in volume the note circulation. Over ninety per cent of the business of the country is done by means of checks drawn against individual deposits. Supporters of the guaranty plan urge, that since deposits are so relatively important and that the profits made by the banker are through the use of the depositor's money, deposits should be insured.

James L. Laughlin, an authority on money and banking, has covered this topic pretty thoroughly. The quotation below is from one of his recent books.

"There is, however, a wide difference between the position of the noteholder and that of the depositor. When a demand-liability of a bank, in the form of a note, comes to be used as money, and is passed from hand to hand by buyers and sellers who have no knowledge whatever of the standing of the issuing bank, it must have universal acceptability. It should be no more necessary for each receiver of a gold coin to stop to test and weigh the fineness of the metal contained in it. It is not in the interest of the bank, but in the interest of the busy public, that protection is thrown around the issue of notes. In its work as a medium of exchange the note often goes forth to a great distance from its place of

issue, and often remains in circulation for a long period before being returned for redemption. It is quite otherwise with the deposit-currency. While the note performs a general and social function, a deposit arises solely from a personal and voluntary act. Deposit-currency can never possess such a universal and general character, because each particular check must always submit to proof of the existence of funds sufficient to meet the order. The noteholder is usually an involuntary, and the depositor a voluntary, creditor of the bank. The use of a deposit always implies recourse to a bank in order to give it effect in payment; while a note requires no proof, no indorsement, no identification in establishing its right to move in the world of exchange. The depositor selects his own bank and takes the risks implied in a voluntary choice, thus becoming responsible for his act, just as one does who gives credit to a buyer or lets a house. Consequently, the reasons for a guaranty of the notes are obvious; while they would have no application to the guaranty of deposits."[1]

4. Panics and Deposit Guaranty. It has been pointed out in chapter V of this thesis that the guaranty legislation in Oklahoma was a result of the panic of 1907. All through the history of guaranty agitation the movement has gained more momentum and aroused more excitement immediately following a period of finan-

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[1] Laughlin, James L., Banking Progress, pp. 85-86.

cial depression. This leads us to the conclusion that proponents of the guaranty idea believe it to be a panacea for panics. Experience with the guaranty of deposits has proved to us in a very convincing manner, that such argument is false. When we compare the losses of state banks with national bank losses in states operating under a guaranty law, we find in every case, that the state bank losses exceed.

The only way to prevent panics is by removing the cause. It is generally conceded that one of the principal causes of panics is speculation and the over-extension of credit. In the final analysis it is a lack of confidence on the part of the depositor in the assets back of his deposits. Deposit guaranty does not prevent speculation and over-extension of credit, but instead tends to promote it. Deposit guaranty will not give complete confidence to depositors unless a fund is maintained equal to the deposits, and this, of course, is absurd.

Mr. Charles W. Stevenson says, "Panics result from a lack of confidence in business conditions....In time of great prosperity deposits sometimes equal as much as five times the amount of money in the whole country. Confidence would be lost under such conditions."[1]

It is sometimes argued by deposit insurance advocates that their plan would prevent "runs" on banks. It must be remembered

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[1] Stevenson, Charles W., Bankers Magazine, 1908, 76:163.

in this connection that a run on a bank is not the cause of weakness of a bank's assets, but a result of a lack of confidence. A run is the consequence of doubt as to the kind of business the bank has been doing, or a result of doubt as to the quality of the assets.

5. Reckless Banking and Deposit Guaranty. One of the most effective arguments that has been produced against the insurance of deposits is that it would wreck any banking system, because it makes all banks equally safe in the eyes of the public. Our banking system is based on the theory that the asset which draws business to a bank is a reputation for honesty, good judgment, and good managerial ability for handling funds on the part of the officers in charge of the bank. If the depositor realizes his risk he will be careful in selecting his banker, and the banker, in order to get business, will exercise careful methods. Deposit Guaranty reverses this theory. The depositor, instead of seeking the most conservative banker will seek the one that is offering the highest rate of interest on deposits, or the one that is most convenient regardless of the reputation of the bank. It is argued that such methods encourage wild-cat banking and dishonesty in banking practice. It is also claimed that this is unfair to the honest and efficient banker who has built up a good reputation through many years of valuable service, because it puts him on the same basis as the beginner who has no reputation to draw customers.

In writing on the subject of reckless banking and deposit guaranty, in 1923, Mr. Taussig, a well known economist, said, "The only feasible method is one of insurance--compulsory contribution by every bank to a public (or publicly supervised) guaranty organization out of which the deposits of a collapsed bank would be met.

"This would destroy one great safegard, the greatest perhaps--that is--the fear of depositor by banks. In other words it may lead to reckless banking. It is better to have the depositor's money tied up during liquidation, this makes the depositor careful of the bank which he selects. This may serve as a check against reckless banking."[1]

Evidence supporting the claim that deposit insurance leads to reckless banking may be gathered from some of the first states to experiment with deposit guaranty. In the case of the Columbia Bank and Trust Company of Oklahoma City we have a good example. It was generally known among the important depositors of the bank that the bank's officers were speculating in oil leases, yet the extra-liberal terms offered to depositors caused the deposits to increase at a tremendously rapid rate. February 1, 1909, the deposits were $1,111,805.64 and on September 1, 1909, they were $2,906,008.61. Thus in seven months the deposits more than doubled. During the first two years of guaranty operation in Oklahoma 138 new state banks were organized. These banks had no reputation to attract

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[1] Taussig, F. W., Principles of Economics, Vol. I, p. 385.

deposits, but thrived wonderfully well in competition with older banks having a good reputation. In other states we find examples of a rapid increase in the number of banks and in deposits soon after the guaranty law went into effect, but we have no convincing proof that this was a direct result of the guaranty law.

6. Taxing Efficient Banks for the Wrongs of the Inefficient. Taxing solvent banks to pay for the losses resulting from poor management, inefficiency, and embezzlement has been a very popular topic during the guaranty movement, especially among bankers. Banking is a competitive business and the profits depend on the size of the deposits, coupled with good management. The amount of deposits depends on the personality and driving power of the banker. This makes him individualistic, and he naturally has a tendency to approach important questions of policy from the standpoint of his own restricted business interest. James B. Forgan, a successful Chicago banker, said a few years ago: "Is there anything in the relations existing between banks and their customers to justify the proposition that in the banking business the good should be taxed to pay for the bad; ability taxed to pay for incompetency; honesty taxed to pay for dishonesty; experience and training taxed to pay for the errors of inexperience and lack of training; and knowledge taxed to pay for the mistakes of ignorence?"[1]

Dr. Raymond V. Phelan, of the University of Minn., 1909, pre-

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[1] Robb, Thomas F., Guaranty of Bank Deposits, p. 193.

sented the other side of this argument. He said, "The guaranty of bank deposits would not be, as many claim, the paying of assessments by honest bankers to meet the deficiencies of crooked bankers. Such argument is somewhat out of order. We all, that is, the honest have to pay taxes to keep up the police force. We pay taxes to light our cities to prevent burglars from stealing from our citizens. Should every one pay or sacrifice what is stolen from him without asking preventative measures from the government?

"The guaranty of bank deposits is in accordance with our present economic life in that it is an assessment for the benefit of the whole. It harmonizes with the present trend of economic life. We are now living in an age of cooperation."[1]

7. What Bankers and Economists Think of Deposit Guaranty. Mr. O. B. Motherseed, present bank commissioner of Oklahoma, said, "It is my judgment that any law which seeks to guarantee deposits in banks is fundamentally unsound, as it places a premium on incompetence, if not actual crookedness, and opens up a field which presents temptations to the unscrupulous politician. In this state it resulted in the granting of charters promiscuously and in many instances charters were granted to inexperienced and incompetent parties."[2]

R. L. Bone, present bank commissioner of Kansas has this to

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1 Phelan, R. V., Bankers Magazine, 1909, 78:78-79.

2 Motherseed, O. B., in a letter to the writer.

say, "The policy of guaranty of deposits is fundamentally unsound in principle."[1]

The heading of an article written by E. S. Sparks, Dean of the College of Agriculture and Science, University of South Dakota, reads as follows:

"After twelve years of operation, the Depositors' Guaranty Fund stands a complete failure. Hopeless deficit growing larger each day. Fund has annual income of less than $300,000 to meet the $50,000,000 indebtedness. Aid to unsound banking."[2]

W. A. Philpott, Jr., Secretary of the Texas Bankers' Association, after the repeal of the Texas guaranty law wrote the following:

"After seventeen years experience and a loss of $20,000,000 the Lone Star State has repealed the statute under which depositors in state banks were guaranteed against loss. The plan at first seemed to be a success but it encouraged laxity."[3]

M. G. Luddy gives these reasons for the failure of the law in South Dakota: "Guaranty of deposits operation has worked a hardship on depositors who eventually pay the losses; because of the delusion that a tax upon the strong will prevent the failure of the weak; guaranty of deposits has proved to be an unsound and treacherous form of mutual insurance in which the rate is not based upon actual

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1 Bone, Roy L., in conversation with the writer.
2 Sparks, E. S., American Bankers Association J., Feb., 1927.
3 Philpott, W. A.Jr., Am. Bankers Association J., Mar., 1927.

and local hazards; the system has and always will place a tool into the hands of unscrupulous and inexperienced persons for reckless banking, with subsequent abnormal increase in deposits; the system penalizes the good banker by making him pay for the follies of the "wildcatter"; and the guaranty or insurance plan is foolhardy where the cooperating insured gamble upon unknown risks as in guaranty of deposits."[1]

C. I. Crawford, when governor of South Dakota, 1909, said, "Since the State or Nation allows banks to use the name 'State' or 'National' on their place of business it is no more than right that the same government which gives the charter should protect the depositor.

"An effective bank deposit insurance law would not only protect depositors against loss by insolvent and mismanaged banks, but it would also protect solvent and well-managed banks against runs and panics."[2]

Van E. Peterson, Secretary of the Guaranty Fund Commission, of Nebraska, September, 1926, said, "Nebraska's Guaranty law has been a success and has paid every depositor in every failed bank of the state one hundred cents on the dollar. Every obligation of the law has been fulfilled over a period of 15 years. All losses now on hand or outstanding indebtedness will be paid in full."[3]

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1 South Dakota Farmer and Breeder, October 1, 1926.
2 Crawford, C. I., Independent, 1909, 65:570.
3 Peterson, Van E., in pamphlet sent to the writer.

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